

***State of Hawaii Department of
Transportation—Airports Division
(An Enterprise Fund of the State of Hawaii)***

*Financial Statements for the Years Ended
June 30, 2004 and 2003, Supplemental
Schedules for the Year Ended June 30,
2004 and Independent Auditors' Report*

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State Of Hawaii)

TABLE OF CONTENTS
JUNE 30, 2004 AND 2003

	Page
Independent Auditors' Report	1-2
Management's Discussion and Analysis	3-15
Financial Statements as of and for the Years Ended June 30, 2004 and 2003:	
Statements of Net Assets	16-18
Statements of Revenues, Expenses and Changes in Net Assets	19-20
Statements of Cash Flows	21-23
Notes to Financial Statements	24-45
Supplementary Information—Schedules as of and for the Year Ended June 30, 2004:	
1—Operating Revenues and Operating Expenses Other Than Depreciation	46
2—Calculations of Net Revenues and Taxes and Debt Service Requirement	47-48
3—Summary of Debt Service Requirements to Maturity	49
4—Debt Service Requirements to Maturity—Airports System Revenue Bonds	50
5—Debt Service Requirements to Maturity—General Obligation Bonds	51
6—Airports System Charges—Fiscal Year 1995-97 Lease Extension	52-54
7—Approved Maximum Revenue Landing Weights and Airport Landing Fees— Signatory Airlines	55
8—Approved Maximum Revenue Landing Weights and Airport Landing Fees— Nonsignatory Airlines	56

INDEPENDENT AUDITORS' REPORT

The Director
Department of Transportation
State of Hawaii:

We have audited the statements of net assets of the Airports Division, Department of Transportation, State of Hawaii (an enterprise fund of the State of Hawaii) (Airports Division) as of June 30, 2004 and 2003, and the related statements of revenues, expenses and changes in net assets, and of cash flows for the years then ended. These financial statements are the responsibility of the Airports Division's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Airports Division at June 30, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, the financial statements present only the activities of the Airports Division and are not intended to present fairly the financial position of the State of Hawaii and the results of its operations, and the cash flows of its proprietary fund type in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis information on pages 3 through 15 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the management of the Airports Division. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying information listed as "supplementary information—schedules as of and for the year ended June 30, 2004" in the foregoing table of contents is presented for the purpose of additional analysis and is not a required part of the financial statements of the Airports Division. These schedules are also the responsibility of the management of the Airports Division. Such additional information has been subjected to the auditing procedures applied in our audit of the financial statements and, in our opinion, is

fairly stated in all material respects when considered in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 27, 2004 on our consideration of the Airports Division's internal control over financial reporting and our tests of its compliance and other matters. The purpose of that report is to describe the scope of our testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

December 27, 2004

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State Of Hawaii)

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004

The following Management's Discussion and Analysis (MD&A) of the Airports Division, Department of Transportation, State of Hawaii (Airports Division) activities and financial performance provides the reader with an introduction and overview to the financial statements of the Airports Division for the fiscal year ended June 30, 2004, with selected comparative information for the year ended June 30, 2003. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

The Airports Division operates and maintains 15 airports at various locations within the State of Hawaii (State) as a single integrated system for management and financial purposes. Honolulu International Airport on the Island of Oahu is the principal airport in the airports system providing facilities for inter-island flights, domestic overseas flights and international flights to destinations in the Pacific Rim. Kahului Airport on the Island of Maui, Hilo International Airport and Kona International Airport at Keahole, both on the Island of Hawaii, and Lihue Airport on the Island of Kauai are the other major airports in the airports system, all of which provide facilities for inter-island flights. Kahului Airport and Kona International Airport at Keahole also provide facilities for direct domestic overseas flights and flights to and from Canada. Lihue Airport also provides facilities for domestic overseas flights. Kona International Airport at Keahole also provides facilities for international flights to and from Japan. The Honolulu International Airport accommodated 58.8% and 60.9% of total passenger traffic in the airports system during fiscal years 2004 and 2003, respectively. The other four principal airports accommodated 39.8% and 37.7% of the total passenger traffic for fiscal years 2004 and 2003, respectively.

The other airports in the airports system are Port Allen on the Island of Kauai, Dillingham Airfield (currently leased from the United States military) and Kalaeloa Airport on the Island of Oahu, Kapalua and Hana Airports on the Island of Maui, Waimea-Kohala and Upolu Airports on the Island of Hawaii, Lanai Airport on the Island of Lanai, and Molokai and Kalaupapa Airports on the Island of Molokai. These facilities are utilized by air carriers, general aviation, and by the military, with the exception of the Upolu and Port Allen Airports, which are used exclusively by general aviation. The Airports Division assumed operations of Kalaeloa Airport (formerly Barbers Point Naval Air Station) on the Island of Oahu as a general reliever airport for the Honolulu International Airport on July 1, 1999. The other airports in the airports system accommodated 1.4% of the total passenger traffic in both fiscal years 2004 and 2003.

The Airports Division is self-sustaining. The Department of Transportation (DOT) is authorized to impose and collect rates and charges for the airports system services and properties to generate revenues to fund operating expenses. The Capital Improvements Program (CIP) is funded by airports system revenue bonds issued by the Airports Division, federal grants, and the Airports Division's revenues.

USING THE FINANCIAL STATEMENTS

The Airports Division is accounted for as a proprietary fund and utilizes the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The proprietary fund includes the enterprise fund type, which is used to account for the

acquisition, operation, and maintenance of government facilities and services that are entirely or predominantly supported by user charges.

The Airports Division's financial report includes three financial statements: the Statement of Net Assets, the Statement of Revenues, Expenses and Changes in Net Assets, and the Statement of Cash Flows. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board (GASB).

AIRPORTS DIVISION ACTIVITIES AND HIGHLIGHTS

The Airports Division ended fiscal year 2004 with slight increases in total passenger activity (2.3%) and deplaning international passengers (1.7%) when compared to fiscal year 2003. However, aircraft operations, landed weights, and revenue passenger landings decreased by 4.6%, 2.5% and 5.6%, respectively, as compared to fiscal year 2003. Aircraft operations were lower due to Aloha Airlines, Inc. and Hawaiian Airlines, Inc. significantly reducing their inter-island flights and with carriers from Japan reducing their flight schedules. Although passenger enplanements increased, landed weights decreased due to airlines phasing out heavier aircraft (DC-10s and 747s) from its Hawaii operations and replacing them with smaller aircraft (Boeing 767-300s). To encourage more direct flights from Honolulu, the DOT implemented an Air Carrier Service Incentive Program designed to attract new non-stop flight service to and from the Honolulu International Airport in which landing fee credits were given for fiscal year 2004. The incentive program provided airline carriers an opportunity to promote Hawaii as a possible profitable operation. Delta Airlines, Inc. added flights from Cincinnati to Honolulu and Atlanta to Honolulu, and China Airlines, Ltd. added flights from Taipei to Honolulu. The airlines are continuing to reduce costs by utilizing lighter, more fuel efficient aircraft due to the rising cost of fuel and reducing the number of flights to increase the passenger load factors. As a result, landing fees, net of aviation fuel tax credits, decreased by \$1.1 million or 3.1% as compared to fiscal year 2003.

Kahului Airport has been the beneficiary of the U.S. visa policy that permits Canadian passengers on direct flights to obtain pre-clearance from immigration and customs. Kahului Airport has also experienced a record growth in direct domestic flights and passenger activity (25.7%) as the Island of Maui remains a favored passenger destination.

The majority of the operating revenues at the Airports Division is activity-based and directly relate to the number of passengers and aircraft operations.

The following airlines serve the State with scheduled or charter overseas passenger flights: Air Canada, Air Japan Co., Ltd., Air New Zealand, Ltd., Air Pacific, Ltd., All Nippon Airways Co., Ltd., Aloha Airlines, Inc., American Airlines, Inc., ATA Airlines, Inc., China Airlines, Ltd., Continental Airlines, Inc., Continental Micronesia, Inc., Delta Airlines, Inc., HMY Airways, Inc., Hawaiian Airlines, Inc., Japan Air Lines Company, Ltd., JALways Co., Ltd., Korean Airlines Company, Ltd., North American Airlines, Northwest Airlines, Inc., Omni Air International, Inc., Philippine Airlines, Inc., Polynesian Limited, Qantas Airways, Ltd., Ryan International Airlines (resumed service in August, 2004) and United Airlines, Inc. The principal airlines providing inter-island passenger flight service are: Aloha Airlines, Inc., Hawaiian Airlines, Inc., Hawaii Island Air, Inc. (formerly Island Air, Inc.) and Trans Executive Airlines of Hawaii, Inc., dba Trans Air.

Activity for the airports system for the fiscal years ended June 30, 2004 and 2003 is as follows:

	2004	2003	% Increase (Decrease) from 2003
Passengers (enplaning and deplaning passengers activity):			
Honolulu International Airport	18,834,007	19,060,548	(1.2)%
Kahului Airport	6,770,464	5,386,688	25.7 %
Lihue Airport	2,526,794	2,524,432	0.1 %
Kona International Airport at Keahole	2,239,411	2,571,730	(12.9)%
Hilo International Airport	1,196,305	1,311,531	(8.8)%
All others	<u>440,960</u>	<u>428,724</u>	2.9 %
Total passengers	<u>32,007,941</u>	<u>31,283,653</u>	2.3 %
Aircraft operations (landing and take-off combined reported by Air Traffic Control Tower):			
Honolulu International Airport	307,507	310,986	(1.1)%
Kahului Airport	151,899	155,727	(2.5)%
Lihue Airport	101,386	98,644	2.8 %
Kona International Airport at Keahole	122,854	123,651	(0.6)%
Hilo International Airport	98,918	102,948	(3.9)%
All others	<u>267,075</u>	<u>308,574</u>	(13.4)%
Total aircraft operations	<u>1,049,639</u>	<u>1,100,530</u>	(4.6)%
Revenue landed weights (1,000 pound units):			
Honolulu International Airport	15,426,920	15,705,743	(1.8)%
Kahului Airport	3,770,773	3,747,099	0.6 %
Lihue Airport	1,587,829	1,631,884	(2.7)%
Kona International Airport at Keahole	1,914,180	1,943,931	(1.5)%
Hilo International Airport	844,685	891,474	(5.2)%
All others	<u>357,813</u>	<u>378,858</u>	(5.6)%
Total signatory airlines	23,902,200	24,298,989	(1.6)%
Nonsignatory airlines	<u>1,681,593</u>	<u>1,944,868</u>	(13.5)%
Total revenue landed weights	<u>25,583,793</u>	<u>26,243,857</u>	(2.5)%

	2004	2003	% Increase (Decrease) from 2003
Revenue passenger landings:			
Honolulu International Airport	62,669	66,014	(5.1)%
Kahului Airport	20,703	22,334	(7.3)%
Lihue Airport	12,446	13,063	(4.7)%
Kona International Airport at Keahole	11,435	12,297	(7.0)%
Hilo International Airport	<u>5,863</u>	<u>6,515</u>	(10.0)%
Total signatory airlines	113,116	120,223	(5.9)%
Nonsignatory airlines	<u>1,413</u>	<u>1,099</u>	28.6 %
Total revenue passenger landings	<u>114,529</u>	<u>121,322</u>	(5.6)%
Deplaning international passengers:			
Honolulu International Airport	1,877,607	1,873,656	0.2 %
Kona International Airport at Keahole	<u>75,065</u>	<u>63,055</u>	19.0 %
Total signatory airlines	1,952,672	1,936,711	0.8 %
Nonsignatory airlines	<u>92,407</u>	<u>74,596</u>	23.9 %
Total deplaning international passengers	<u>2,045,079</u>	<u>2,011,307</u>	1.7 %

FINANCIAL OPERATIONS HIGHLIGHTS

The financial results for fiscal year 2004 were significantly affected by the decrease in concession revenue and interest income and the continued impact from the events of September 11, 2001. As a result, net assets decreased by \$17.8 million for fiscal year 2004, as compared to an increase of \$1.5 million for fiscal year 2003.

Concession revenues decreased by \$17.1 million primarily due to the withdrawal and settlement agreement with the DFS Group L.P., which lowered the minimal annual guarantee rent. In addition, the State and the Airlines Committee of Hawaii (ACH), representing the airline lessees, reached a settlement to transfer \$5.4 million into the Prepaid Airport Use Charge Fund, resolving a dispute with signatory airlines regarding the overpayment in airports system charges. As a result, operating revenues amounted to \$214.9 million, \$22.1 million less than fiscal year 2003.

Nonoperating revenues decreased by \$11.9 million mainly due to the decrease in interest income as a result of the nominal rate of return on cash investments.

In addressing the large anticipated revenue shortfall, the Airports Division implemented a financial management plan to monitor monthly expenditures. The Airports Division restricted Legislative appropriations by \$16 million or 10% for planned expenditures. Quarterly management meetings were held to review the financial performance of the airports and to forecast revenues and expenditures for personnel, special maintenance, and capital projects for the next quarter. By providing the airport managers budgetary financial results, along with a forecasted financial position of the Airports Division, managers were given a new focus and the flexibility to operate their airports within financial constraints. In a marketing strategy to attract new direct flights from destinations not served by a carrier, the Airports Division created a new airline incentive for Honolulu International Airport – a first for the State of

Hawaii. The incentive provided the airline station managers an opportunity to promote Hawaii to their airline corporate offices and flight planners as a profitable destination.

Other sources of revenues such as landing fees and aeronautical/non-aeronautical rentals appear to have stabilized.

The events of September 11, 2001 have also permanently impacted security and insurance costs. Post 9/11 costs for security and insurance have increased by an average of \$10.8 million and \$1.7 million per year, respectively.

During fiscal year 2004, the Airports Division regained its eligibility for federal discretionary grants on July 27, 2003. The Airports will use the federal grants to replace and maintain equipment and facilities while using only 5% to 25% State matching monies at the various airports as a nonoperating source of cash to finance its needs.

Beginning October 1, 2004, Passenger Facility Charges (PFC) will be implemented, thus creating another source of funding for FAA approved airport capital projects. The PFC is projected to generate approximately \$18 million per year. This will preserve a portion of the Airports Division's principal cash investments used to earn interest income. In addition, based upon the Federal Reserve's increasing short-term interest rate, we expect interest income to rise.

The Airports Division issued \$80.9 million of Airports System Revenue Bonds, Refunding Series of 2003 to refund \$80.3 million of Refunding Series of 1993 bonds still outstanding. The Refunding Series of 1993 bonds carried a fixed rate of 6.05% to 6.45% while the Refunding Series of 2003 had an initial rate of 2% per annum through June 30, 2004, and a fixed weekly rate thereafter. In January 2005, the outstanding balance of \$69.3 million of the Series of 2003 will be redeemed, resulting in a reduction in the annual debt service requirement for fiscal year 2006 by approximately \$14.2 million.

In summary, additional sources of funding from federal discretionary grants, the implementation of the PFC to fund certain airport improvement projects, the conversion of fixed to variable rate bonds, reduction of expenditures via budget restrictions, and instituting financial performance reviews has resulted in bond rating agencies (Standard & Poor's Corporation and Moody's Investors Service) upgrading the outlook of Hawaii's airports from negative to stable. Therefore, the future financial outlook for the Airports Division remains optimistic and healthy.

A summary of operations and changes in net assets for the years ended June 30, 2004 and 2003 follows:

	2004	2003
Operating revenues	\$ 214,878,750	\$ 236,970,750
Operating expenses, excluding depreciation	<u>(149,811,296)</u>	<u>(165,895,285)</u>
Operating income before depreciation	65,067,454	71,075,465
Depreciation	<u>(79,032,618)</u>	<u>(78,204,779)</u>
Operating loss	(13,965,164)	(7,129,314)
Nonoperating expenses—net	<u>(25,831,002)</u>	<u>(13,909,406)</u>
Loss before capital contributions and transfers	<u>(39,796,166)</u>	<u>(21,038,720)</u>
Capital contributions and transfers:		
Federal capital grants	19,736,032	22,536,388
Other capital contribution	<u>2,300,000</u>	<u> </u>
Total capital contributions and transfers	<u>22,036,032</u>	<u>22,536,388</u>
Increase (decrease) in net assets	<u><u>\$ (17,760,134)</u></u>	<u><u>\$ 1,497,668</u></u>

- Operating revenues decreased by 9.3% from \$236.9 million in fiscal year 2003 to \$214.9 million in fiscal year 2004. The primary reasons for the decrease were the concession revenues (DFS Group, L.P. settlement agreement) and the refunding of airport system support charge overpayments dating back to fiscal year 1995. After a significant amount of negotiation between the State and DFS Group, L.P., (DFS) both parties entered into a Withdrawal and Settlement Agreement ("Agreement"), effective August 1, 2003. Under the terms of the Agreement, DFS would bring current the amounts due for the in-bond concession, based on compromised amounts. The settlement agreement, allowed the Minimum Annual Guarantee (MAG) rent to be adjusted from \$60 million to \$43.6 million for fiscal year 2004. In addition, in fiscal year 2004, the State reached a settlement with the ACH under which the Airports Division is to transfer \$5.4 million of overpayments to the Prepaid Airport Use Charge Fund escrow account in four equal annual installments beginning in fiscal year 2004.
- Operating expenses excluding depreciation decreased by 9.7% from \$165.9 million in fiscal year 2003 to \$149.8 million in fiscal year 2004. The primary reasons were decreases in bad debts expense of \$11.9 million, salaries and wages of \$2.7 million, security costs of \$2.2 million, and special maintenance of \$2.5 million, offset by an increase of \$2.1 million in the DOT general administrative costs. Such expenses are allocated to the various divisions based on their pro rata share of the DOT expenses. The Airports Division's share increased due to decreases in expenditures by the other DOT divisions.

The decrease in bad debts expense of \$11.9 million was mainly due to the one-time \$10.0 million bad debt allowance for the in-bond concession contract representing a MAG rent adjustment from January 1, 2003 to June 30, 2003 in accordance with the settlement agreement for fiscal year 2003. See Note 8 for additional information. The \$2.7 million decrease in salaries and wages was primarily due to unfilled permanent vacancies and a decrease in overtime. Security costs decreased by \$2.2 million due to only one terror alert level increase requirement by the Transportation Security Administration (TSA) during the fiscal year. This resulted in fewer security man-hour charges as compared to fiscal years 2002 and 2003. Special maintenance expenses were reduced by \$2.5 million

due to the use of federal grants in lieu of airport special funds to fund eligible special maintenance projects.

- The net results of the above resulted in operating income before depreciation decreasing by 8.4% or \$6.0 million from fiscal year 2003. Depreciation expense increased by 1.1% from \$78.2 million to \$79.0 million. The operating loss, before nonoperating expenses-net, of \$14.0 million in fiscal year 2004, represents a 95.9% increase from the operating loss of \$7.1 million in fiscal year 2003.
- Nonoperating expenses-net increased by 85.7% or \$11.9 million in fiscal year 2004, primarily due to the decrease from investment interest income.
- Loss before capital contributions and transfers increased by 89.0% or \$18.7 million in fiscal year 2004 due to a decrease in both operating income before depreciation and nonoperating income.

FINANCIAL POSITION SUMMARY

A condensed summary of the Airports Division's net assets at June 30, 2004 and 2003 is shown below:

	2004	2003
ASSETS:		
Current assets:		
Unrestricted assets	\$ 608,278,459	\$ 612,455,472
Restricted assets	237,623,668	247,195,323
Noncurrent assets:		
Other assets	11,558,178	5,939,035
Restricted assets	40,263,001	41,118,410
Capital assets	<u>1,447,216,166</u>	<u>1,485,668,685</u>
Total	<u>\$2,344,939,472</u>	<u>\$2,392,376,925</u>
LIABILITIES:		
Current liabilities:		
Payable from unrestricted assets	\$ 31,459,329	\$ 28,108,790
Payable from restricted assets	36,867,079	47,684,537
Long-term liabilities	<u>811,000,762</u>	<u>833,211,162</u>
Total	<u>\$ 879,327,170</u>	<u>\$ 909,004,489</u>
NET ASSETS:		
Invested in capital assets—net of related debt	\$ 732,069,945	\$ 740,114,374
Restricted	158,918,391	167,154,587
Unrestricted	<u>574,623,966</u>	<u>576,103,475</u>
Total	<u>\$1,465,612,302</u>	<u>\$1,483,372,436</u>

The largest portion of the Airports Division's net assets (49.9% at June 30, 2004 and 2003) represents its investments in capital assets (e.g., land, buildings improvements, and equipment), less related indebtedness outstanding to acquire those capital assets. The Airports Division uses these capital assets to provide services to its passengers and visitors using the airports system; consequently, these assets are not available for future spending. Although the Airports Division's investment in its capital assets is reported

net of related debt, the resources required to repay this debt must be provided annually from operations, since it is unlikely the capital assets themselves will be liquidated to pay such liabilities.

The restricted portion of the Airports Division's net assets (10.8% at June 30, 2004 and 11.3% at June 30, 2003) represents bond reserve funds that are subject to external restrictions on how they can be used under the *Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Airports System Revenue Bonds* (Certificate).

The largest portion of the Airports Division's unrestricted net assets represents unrestricted cash in the amount of \$592.6 million at June 30, 2004 and \$572.9 million at June 30, 2003. The sizable cash balance provides the Airports Division with substantial flexibility, as the unrestricted assets may be used to meet any of the Airports Division's ongoing operations and to fund the CIP projects. In addition, the implementation of the PFC, geared to support the CIP, will help preserve the cash balance.

The change in net assets is an indicator of whether the overall fiscal condition of the Airports Division has improved or worsened during the year. The change in net assets may serve over time as a useful indicator of the Airports Division's financial position. The net assets exceeded liabilities by \$1,465.6 million at June 30, 2004, representing a decrease of \$17.8 million from June 30, 2003.

AIRLINE SIGNATORY RATES AND CHARGES

Lease Agreement with Signatory Airlines

The DOT entered into an airport-airline lease agreement with the signatory airlines to provide those airlines with the nonexclusive right to use the airports system facilities, equipment improvements, and services, in addition to occupying certain exclusive-use premises and facilities. These leases were set to expire in 1992 but were extended under various short-term agreements.

In June 1994, the DOT and the signatory airlines executed a lease extension agreement to extend the airport-airline lease agreement effective July 1, 1994 to June 30, 1997. Under the terms of the lease extension agreement, the signatory airlines would continue to operate under the terms of the airport-airline lease agreement, with an adjustment for terms and provisions relating to airports system rates and charges. The lease extension agreement's residual rate-setting methodology provided for a final year-end reconciliation containing actual airports system cost data to determine whether airports system charges assessed to the signatory airlines were sufficient to recover airports system costs, including debt service requirements. Annual settlements based on this final reconciliation were made in accordance with the terms of the lease extension agreement and various agreements between the DOT and airlines since June 30, 1997. The final reconciliation for fiscal years 2004 and 2003 in accordance with these agreements resulted in a net underpayment by the signatory airlines of \$1,217,210 and \$1,438,346, respectively. For fiscal year 2004, the State waived \$1,631,867 of signatory airlines underpayment of nonexclusive joint-use premise charges and will transfer \$414,657 of overpayments into the PAUCF. For fiscal year 2003, the underpayment of \$1,438,346 was waived.

The DOT and the signatory airlines have mutually agreed to continue to operate under the terms of the lease extension agreement, which provides for an automatic extension on a quarterly basis unless either party provides 60-days written notice of termination to the other party.

No active negotiations are being conducted with the signatory airlines for a new airport-airline use agreement to replace the existing lease extension agreement.

In the event the lease extension agreement is terminated without a new agreement in place, it is possible that all airlines using the Airports System would be treated as nonsignatory airlines and obligated to pay fees and charges in accordance with the Administrative Rules.

The following summarizes the rates in effect at June 30, 2004 and 2003.

	2004	2003
Airport landing fees (per 1,000 pound units of landed weights):		
Signatory airlines:		
Overseas flights	\$ 1.930	\$ 1.930
Inter-island flights	0.695	0.695
Nonsignatory airlines:		
Overseas flights	2.980	2.980
Inter-island flights	0.954	0.954
Nonexclusive joint-use premise charges:		
Overseas and inter-island terminal joint-use charges (per revenue passenger landing):		
Signatory airlines:		
Overseas terminal	520.372	520.372
Blended overseas	400.140	400.140
Inter-island terminal	77.281	77.281
Nonsignatory airlines:		
Overseas terminal	457.344	457.344
Inter-island terminal	69.375	69.375
International arrivals building charges (per deplaning international passenger):		
Signatory airlines	4.029	4.029
Nonsignatory airlines	3.346	3.346
Neighbor-island terminals joint-use charges (per revenue passenger landing)—Signatory airlines	15.378	15.378
Airports system support charges (per 1,000 pound units of landed weights)—Nonsignatory airlines:		
Overseas flights	0.618	0.618
Inter-island flights	0.198	0.198

Additional information on the Airports Division's rates and charges can be found in Note 8 of this report.

REVENUES

A summary of revenues for the year ended June 30, 2004 and the amount and percentage of change in relation to prior year amounts is as follows:

	2004		Increase (Decrease) from 2003	
	Amount	Percent of Total	Amount	Percent
OPERATING:				
Concession fees:				
Duty Free	\$ 43,644,697	18.4 %	\$ (16,355,303)	(27.3)%
Other concessions	71,094,061	30.0 %	(784,134)	(1.1)%
Airport landing fees	33,517,262	14.1 %	(1,062,429)	(3.1)%
Aeronautical rentals:				
Exclusive-use premise charges	27,092,618	11.4 %	(604,727)	(2.2)%
Nonexclusive joint-use premise charges	24,902,421	10.5 %	(193,521)	(0.8)%
Nonaeronautical rentals	12,060,261	5.1 %	2,492,094	26.0 %
Aviation fuel tax	2,931,685	1.2 %	77,562	2.7 %
Airports system support charges	(4,682,685)	(2.0)%	(5,578,794)	(622.6)%
Miscellaneous	4,318,430	1.8 %	(82,748)	(1.9)%
Total operating	<u>214,878,750</u>	90.6 %	<u>(22,092,000)</u>	(9.3)%
NONOPERATING:				
Interest income, investments	17,928,374	7.6 %	(7,726,214)	(30.1)%
Interest income, direct financing leases	2,929,183	1.2 %	(68,258)	(2.3)%
Federal operating grants	1,480,168	0.6 %	(1,607,952)	(52.1)%
Gain on disposal of capital assets			<u>(2,122,601)</u>	(100.0)%
Total nonoperating	<u>22,337,725</u>	9.4 %	<u>(11,525,025)</u>	(34.0)%
TOTAL REVENUES	<u>\$237,216,475</u>	100.0 %	<u>\$ (33,617,025)</u>	(12.4)%

EXPENSES

A summary of expenses for the year ended June 30, 2004, and the amount and percentage of change in relation to prior year amounts is as follows:

	2004		Increase (Decrease) from 2003	
	Amount	Percent of Total	Amount	Percent
OPERATING:				
Salaries and wages	\$ 50,912,748	18.4 %	\$ (2,671,252)	(5.0)%
Other personnel services	37,535,231	13.6 %	(2,197,655)	(5.5)%
Utilities	18,622,657	6.7 %	234,021	1.3 %
Bad debt expense	923,511	0.3 %	(11,869,841)	(92.8)%
Repairs and maintenance	10,102,772	3.6 %	(199,352)	(1.9)%
State of Hawaii surcharge on gross receipts	9,771,402	3.5 %	1,253,527	14.7 %
Special maintenance	5,222,256	1.9 %	(2,463,866)	(32.1)%
Materials and supplies	4,664,290	1.7 %	479,640	11.5 %
Department of Transportation general administration expenses	5,655,422	2.0 %	2,078,184	58.1 %
Insurance	2,647,008	1.0 %	(169,601)	(6.0)%
Disbursements out of major maintenance, renewal and replacement account	1,192,459	0.4 %	(309,460)	(20.6)%
Claims and benefits—payments made during the year	1,279,127	0.5 %	(149,807)	(10.5)%
Communication	372,192	0.1 %	27,814	8.1 %
Rent	268,590	0.1 %	(1,569)	(0.6)%
Travel	262,254	0.1 %	(7,010)	(2.6)%
Dues and subscriptions	85,389	0.0 %	(86,217)	(50.2)%
Printing and advertising	12,712	0.0 %	(15,331)	(54.7)%
Freight and delivery	15,659	0.0 %	2,848	22.2 %
Miscellaneous	265,617	0.1 %	(19,062)	(6.7)%
Total operating	<u>149,811,296</u>	54.1 %	<u>(16,083,989)</u>	(9.7)%
DEPRECIATION	<u>79,032,618</u>	28.5 %	<u>827,839</u>	1.1 %
NONOPERATING:				
Interest expense:				
Revenue bonds:				
Airports system	40,284,848	14.5 %	(3,769,425)	(8.6)%
Special facility	2,929,183	1.1 %	(68,258)	(2.3)%
General obligation bonds	2,835	0.0 %	(1,809)	(39.0)%
Loss on redemption of bonds	3,466,208	1.3 %	3,466,208	0.0 %
Other expense	1,485,653	0.5 %	769,855	107.6 %
Total nonoperating	<u>48,168,727</u>	17.4 %	<u>396,571</u>	0.8 %
TOTAL EXPENSES	<u>\$ 277,012,641</u>	100.0 %	<u>\$ (14,859,579)</u>	(5.1)%

SUMMARY OF CASH FLOW ACTIVITIES

The following shows a summary of the major sources and uses of cash and cash equivalents for the fiscal years ended June 30, 2004 and 2003. Cash equivalents include highly liquid investments with an original maturity of three months or less.

	2004	2003
Cash flow provided by operating activities	\$ 77,610,912	\$ 58,489,515
Cash flow provided by noncapital financing activities	3,005,100	6,111,664
Cash flow used in capital and related financing activities	(88,574,323)	(101,498,868)
Cash flow provided by investing activities	<u>18,127,938</u>	<u>26,378,621</u>
Net decrease in cash and cash equivalents	10,169,627	(10,519,068)
Cash and cash equivalents, beginning of year	<u>734,801,051</u>	<u>745,320,119</u>
Cash and cash equivalents, end of year	<u>\$ 744,970,678</u>	<u>\$ 734,801,051</u>

CAPITAL ACQUISITIONS AND CONSTRUCTION ACTIVITIES

In fiscal year 2004, there were five construction bid openings totaling an estimated \$26 million in construction contracts. Significant projects include the General Aviation Apron, Phase II at Lihue Airport; Architectural Barrier Removal at Honolulu International Airport; and Terminal Improvements, Phase IA at Kahului Airport.

There were also several ongoing construction projects that were initiated prior to fiscal year 2004 that were under construction during the fiscal year. These projects include Overseas Terminal Improvements, Phase II at Honolulu International Airport; Electrical System Upgrade for TSA at Honolulu International Airport; and Kalaeloa Airport Improvements at Kalaeloa Airport. These projects total approximately \$25.7 million in construction contracts.

Finally, there were 12 construction projects that were completed in fiscal year 2004. These projects total over \$37.6 million in construction contracts and include Ticket Lobby Canopies at Honolulu International Airport; Terminal Roof Replacement at Hilo International Airport; General Aviation Site preparations at Kona International Airport; and Statewide Architectural Barrier Removal Phase III at Maui and Hawaii Airports. During fiscal year 2004, the Airports Division expended over \$41 million on capital activities.

Additional information on the Airports Division's capital assets can be found in Note 4 of this report.

INDEBTEDNESS

Airports System Revenue Bonds and Reimbursable General Obligation Bonds

As of July 1, 2004, \$768,245,000 of airports system revenue bonds was outstanding compared to \$790,020,000 as of July 1, 2003. The last series of "new money" bonds used to fund capital improvement projects was issued in December 1991. The Airports Division has managed its debt levels by issuing refunding bonds and defeasing bonds with unencumbered cash from the Airport Revenue Fund. As of June 30, 2004 and 2003, \$20,193,576 and \$38,696 of authorized but unissued airports system revenue bonds lapsed. On July 1, 2004, there was legislative authorization to issue additional bonds of \$38,400,000.

As of June 30, 2004, \$65,975 of reimbursable general obligation bonds issued for the airports system was outstanding compared to \$75,402 as of June 30, 2003. These bonds are general obligations of the State, but since the proceeds were used to finance improvements to the airports system, the Airports Division is required to reimburse the State's general fund for the payment of the principal and interest on such bonds. The State does not presently intend to issue additional reimbursable general obligation bonds for the airports system.

Special Obligation Bonds

The State Legislature has authorized \$200,000,000 of special obligation bonds pursuant to Section 261-52 of the Hawaii Revised Statutes. As of June 30, 2004, there were outstanding bond obligations of \$39,995,000 and \$40,845,000 as of June 30, 2003. The DOT expects to finance additional special facility projects from time to time for qualified entities. All special obligation bonds are payable solely from the revenues derived from the leasing of special facilities financed with the proceeds of special obligation bonds.

Additional information regarding the Airports Division's indebtedness can be found in Notes 6, 7 and 8 of this report.

CREDIT RATING AND BOND INSURANCE

All airports system revenue bonds issued since 1989 have been issued with bond insurance and are rated AAA by Standard & Poor's Corporation, Aaa by Moody's Investors Service, and AAA by Fitch IBCA, Inc. As of May 2004, the underlying ratings for airports system revenue bonds were as follows:

- Standard & Poor's Corporation: A- (with stable outlook), which is slightly below the rating agency's median for Airports (A).
- Moody's Investors Service: A3 (with stable outlook), which is slightly below the rating agency's median for airports (A2).
- Fitch IBCA, Inc.: A (with negative outlook), which is slightly below the rating agency's median rating for Airports (A+).

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the Airports Division's finances for all interested parties. Questions concerning any of the information provided in this report or requests for additional information should be addressed in writing to Brian Sekiguchi, Deputy Director, State of Hawaii, Department of Transportation, Airports Division, 400 Rodgers Boulevard, Suite 700, Honolulu, Hawaii 96819-1880, or by e-mail to airadministrator@hawaii.gov.

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

STATEMENTS OF NET ASSETS
JUNE 30, 2004 AND 2003

ASSETS	2004	2003
CURRENT ASSETS:		
Unrestricted assets:		
Cash and cash equivalents (Note 3)	\$ 592,631,186	\$ 572,889,904
Receivables:		
Accounts—net of allowance of \$6,860,951 and \$16,118,548 for uncollectible accounts	10,725,486	30,762,150
Interest	2,056,172	2,255,736
Claims—federal grants	2,099,010	5,259,144
Aviation fuel tax	159,672	179,970
Due from State of Hawaii	415,591	906,686
Total receivables	15,455,931	39,363,686
Inventory of materials and supplies, at cost	191,342	201,882
Total unrestricted current assets	608,278,459	612,455,472
Restricted assets:		
Cash and cash equivalents (Note 3):		
Revenue bond debt service (Note 6)	94,435,084	105,763,494
Revenue bond construction	53,139,020	53,156,796
Security deposits and customer advance	4,765,388	2,990,857
Total cash and cash equivalents—restricted	152,339,492	161,911,147
Investments—revenue bond debt service reserve (Notes 3 and 6)	85,284,176	85,284,176
Total restricted current assets	237,623,668	247,195,323
Total current assets	845,902,127	859,650,795
NONCURRENT ASSETS:		
Promissory note receivable (Note 8)	6,024,102	
Bond issue costs—net of accumulated amortization of \$2,055,807 and \$4,485,932 (Note 6)	5,534,076	5,939,035
Restricted assets—net investments in direct financing leases (Note 8)	40,263,001	41,118,410
Capital assets—net of accumulated depreciation of \$1,125,134,693 and \$1,057,277,250 (Notes 4, 6 and 7)	1,447,216,166	1,485,668,685
Total noncurrent assets	1,499,037,345	1,532,726,130
TOTAL ASSETS	\$2,344,939,472	\$2,392,376,925

(Continued)

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

STATEMENTS OF NET ASSETS
JUNE 30, 2004 AND 2003

LIABILITIES AND NET ASSETS	2004	2003
CURRENT LIABILITIES:		
Payable from unrestricted assets:		
Vouchers payable	\$ 3,787,525	\$ 3,872,995
Contracts payable (including retainage of \$2,488,779 and \$3,449,055)	11,036,345	16,334,055
Current portion of general obligation bonds (Notes 5 and 7)	9,425	9,427
Deferred income (Note 8)	5,360,679	237,409
Current portion of workers' compensation (Notes 5 and 13)	871,392	858,782
Current portion of compensated absences (Note 5)	2,427,847	2,426,163
Accrued wages	3,470,992	3,519,136
Prepaid airport use charge fund (Note 8)	4,468,666	8,665
Other	26,458	842,158
Total payable from unrestricted assets	31,459,329	28,108,790
Payable from restricted assets:		
Contracts payable (including retainage of \$99,520 and \$126,564)	214,910	126,608
Current portion of airports system revenue bonds (Notes 5 and 6)	10,765,000	19,550,000
Current portion of special facility revenue bonds (Notes 5 and 8)	1,005,000	850,000
Accrued interest	21,069,382	24,167,072
Security deposits	3,812,787	2,990,857
Total payable from restricted assets	36,867,079	47,684,537
Total current liabilities	68,326,408	75,793,327
LONG-TERM LIABILITIES—Net of current portion:		
Customer advance (Note 12)	952,601	
Compensated absences (Note 5)	4,784,660	4,884,229
Workers' compensation (Notes 5 and 13)	3,228,608	3,241,218
General obligation bonds (Notes 5 and 7)	56,550	65,975
Airports system revenue bonds (Notes 5 and 6)	762,988,343	785,024,740
Special facility revenue bonds (Notes 5 and 8)	38,990,000	39,995,000
Total liabilities	879,327,170	909,004,489
COMMITMENTS AND CONTINGENCIES (Notes 8, 9, 12, 13 and 14)		

(Continued)

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

STATEMENTS OF NET ASSETS
JUNE 30, 2004 AND 2003

LIABILITIES AND NET ASSETS (Continued)	2004	2003
NET ASSETS:		
Invested in capital assets—net of related debt	\$ 732,069,945	\$ 740,114,374
Restricted—reserved for revenue bond requirements:		
Debt service payment	10,765,000	19,550,000
Debt service reserve account	85,284,176	85,284,176
Major maintenance, renewal and replacement account	62,869,215	62,320,411
Total restricted	158,918,391	167,154,587
Unrestricted	574,623,966	576,103,475
Total net assets	1,465,612,302	1,483,372,436
TOTAL LIABILITIES AND NET ASSETS	\$2,344,939,472	\$2,392,376,925

See accompanying notes to financial statements.

(Concluded)

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
OPERATING REVENUES (Notes 8, 11 and 14):		
Concession fees	\$ 114,738,758	\$ 131,878,195
Airport landing fees	33,517,262	34,579,691
Aeronautical rentals:		
Exclusive-use premise charges	27,092,618	27,697,345
Nonexclusive joint-use premise charges	24,902,421	25,095,942
Nonaeronautical rentals	12,060,261	9,568,167
Aviation fuel tax	2,931,685	2,854,123
Airports system support charges	(4,682,685)	896,109
Miscellaneous	4,318,430	4,401,178
	<u>214,878,750</u>	<u>236,970,750</u>
Total operating revenues		
OPERATING EXPENSES (Notes 8, 9, 10, 11, 12, 13 and 14):		
Salaries and wages	50,912,748	53,584,000
Other personnel services	37,535,231	39,732,886
Utilities	18,622,657	18,388,636
Repairs and maintenance	10,102,772	10,302,124
State of Hawaii surcharge on gross receipts	9,771,402	8,517,875
Department of Transportation general administration expenses	5,655,422	3,577,238
Special maintenance	5,222,256	7,686,122
Materials and supplies	4,664,290	4,184,650
Insurance	2,647,008	2,816,609
Claims and benefits	1,279,127	1,428,934
Disbursements out of major maintenance, renewal and replacement account	1,192,459	1,501,919
Bad debt expense	923,511	12,793,352
Communication	372,192	344,378
Rent	268,590	270,159
Travel	262,254	269,264
Dues and subscriptions	85,389	171,606
Freight and delivery	15,659	12,811
Printing and advertising	12,712	28,043
Miscellaneous	265,617	284,679
Depreciation	79,032,618	78,204,779
	<u>228,843,914</u>	<u>244,100,064</u>
Total operating expenses		
OPERATING LOSS (Forward)	<u>(13,965,164)</u>	<u>(7,129,314)</u>

(Continued)

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
OPERATING LOSS (Forwarded)	\$ (13,965,164)	\$ (7,129,314)
NONOPERATING REVENUES (EXPENSES):		
Interest income:		
Certificates of deposit, repurchase agreements and U.S. government securities	17,928,374	25,654,588
Investments in direct financing leases (Note 8)	2,929,183	2,997,441
Interest expense:		
Revenue bonds:		
Airports system (Note 6)	(40,284,848)	(44,054,273)
Special facility (Note 8)	(2,929,183)	(2,997,441)
General obligation bonds (Note 7)	(2,835)	(4,644)
Federal operating grants	1,480,168	3,088,120
Gain (loss) on disposal of capital assets (Note 4)	(3,466,208)	2,122,601
Other	<u>(1,485,653)</u>	<u>(715,798)</u>
Nonoperating expenses—net	<u>(25,831,002)</u>	<u>(13,909,406)</u>
LOSS BEFORE CAPITAL CONTRIBUTIONS AND TRANSFERS	<u>(39,796,166)</u>	<u>(21,038,720)</u>
CAPITAL CONTRIBUTIONS AND TRANSFERS:		
Federal capital grants	19,736,032	22,536,388
Other capital contribution	<u>2,300,000</u>	<u> </u>
Total capital contributions and transfers	<u>22,036,032</u>	<u>22,536,388</u>
INCREASE (DECREASE) IN NET ASSETS	(17,760,134)	1,497,668
TOTAL NET ASSETS, BEGINNING OF YEAR	<u>1,483,372,436</u>	<u>1,481,874,768</u>
TOTAL NET ASSETS, END OF YEAR	<u><u>\$ 1,465,612,302</u></u>	<u><u>\$ 1,483,372,436</u></u>

See accompanying notes to financial statements.

(Concluded)

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from providing services	\$ 238,501,112	\$ 233,342,724
Cash paid to suppliers	(109,831,423)	(122,146,101)
Cash paid to employees	<u>(51,058,777)</u>	<u>(52,707,108)</u>
Net cash provided by operating activities	<u>77,610,912</u>	<u>58,489,515</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES—Proceeds from federal operating grants	<u>3,005,100</u>	<u>6,111,664</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition and construction of capital assets	(33,438,499)	(45,963,976)
Proceeds from federal and other capital grants and contributions	23,671,234	18,339,771
Customer advance	952,601	
Interest paid on airports system revenue and general obligation bonds	(46,065,061)	(48,555,898)
Principal paid on general obligation bonds	(9,427)	(273,765)
Principal paid on airports system revenue bonds	(31,150,000)	(27,185,000)
Proceeds from disposal of capital assets		2,140,000
Payments to refund airport system revenue bonds	(83,035,655)	
Proceeds from issuance of refunding airport system revenue bonds	81,581,178	
Bond issue costs paid	<u>(1,080,694)</u>	<u></u>
Net cash used in capital and related financing activities	<u>(88,574,323)</u>	<u>(101,498,868)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale and maturities of investments	85,284,176	99,475,676
Interest received on investments	18,127,938	26,378,621
Purchases of investments	<u>(85,284,176)</u>	<u>(99,475,676)</u>
Net cash provided by investing activities	<u>18,127,938</u>	<u>26,378,621</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	10,169,627	(10,519,068)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>734,801,051</u>	<u>745,320,119</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 744,970,678</u>	<u>\$ 734,801,051</u>

(Continued)

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating loss	\$ (13,965,164)	\$ (7,129,314)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	79,032,618	78,204,779
Settlement of airport use charge overpayment	5,393,344	
Bad debt expense	923,511	12,793,352
Overpayment of airport use charge to be transferred to the PAUCF	414,657	
Changes in operating assets and liabilities:		
Accounts receivable	13,089,051	(15,187,177)
Aviation fuel tax receivable	20,298	118,524
Inventory of materials and supplies	10,540	16,826
Vouchers payable	(85,470)	(2,139,770)
Contracts payable	(11,349,039)	(6,331,394)
Deferred income	5,123,270	(328,312)
Accrued wages	(146,029)	876,892
Prepaid airport use charge fund	(1,348,000)	(460,000)
Due to State of Hawaii	491,095	(1,380,478)
Security deposits	821,930	249,645
Other	(815,700)	(814,058)
Net cash provided by operating activities	<u>\$ 77,610,912</u>	<u>\$ 58,489,515</u>

SUPPLEMENTAL INFORMATION—NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:

- The Airports Division's noncash capital and financing activities related to bonds payable included the following:

Principal payments relating to special facility revenue bonds	\$ 850,000	\$ 820,000
Interest payments relating to special facility revenue bonds	2,934,592	3,002,678
Amortization of revenue bond issue costs	1,485,653	715,798
Amortization of revenue bond discount	303,529	149,429
Amortization of revenue bond premium	1,755,028	1,580,376
Amortization of deferred loss on refunding revenue bonds	2,390,242	1,907,907

(Continued)

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2004 AND 2003

SUPPLEMENTAL INFORMATION—NONCASH INVESTING,
CAPITAL AND FINANCING ACTIVITIES (Continued):

- At June 30, 2004 and 2003, contracts payable included \$6,139,631 and \$8,557,126, respectively, for the acquisition of capital assets.
- During fiscal years 2004 and 2003, interest of \$4,468,177 and \$4,209,245, respectively, was capitalized in property, plant and equipment.
- During fiscal years 2004 and 2003, property, plant, and equipment with a net book value of \$3,466,208 and \$17,399, respectively, were written off.

See accompanying notes to financial statements.

(Concluded)

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2004 AND 2003

1. REPORTING ENTITY

The Airports Division, Department of Transportation, State of Hawaii (Airports Division), was established on July 1, 1961 to succeed the Hawaii Aeronautics Commission under the provisions of Act 1, Hawaii State Government Reorganization Act of 1959, Second Special Session Laws of Hawaii. The Airports Division has jurisdiction over and control of all State of Hawaii (State) airports and air navigation facilities and general supervision of aeronautics within the State. The Airports Division currently operates and maintains 15 airports located throughout the State.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting—The Airports Division is accounted for as a proprietary fund, which uses the flow of economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The proprietary fund includes the enterprise fund type. An enterprise fund is used to account for the acquisition, operation, and maintenance of government facilities and services that are entirely or predominantly supported by user charges.

Financial Statement Presentation—The accompanying financial statements are presented in accordance with the pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the Airports Division has elected not to apply the provisions of relevant pronouncements of the Financial Accounting Standards Board issued after November 30, 1989.

Operating Revenues and Expenses—Revenues from airlines, concessions, rental cars, and parking are reported as operating revenues. Transactions that are capital, financing, or investing related are reported as nonoperating revenues. All expenses related to operating the Airports Division are reported as operating expenses. Interest expense and financing costs are reported as nonoperating expenses. Revenues from capital contributions are reported separately, after nonoperating revenues and expenses.

Cash and Cash Equivalents—All highly liquid investments (including restricted assets) with a maturity of three months or less when purchased are considered to be cash equivalents. Cash and cash equivalents include amounts held in the State Treasury. The State Director of Finance is responsible for the safekeeping of all monies paid into the State Treasury (cash pool). The Airports Division's portion of this cash pool at June 30, 2004 and 2003 is described in Note 3. The Hawaii Revised Statutes authorize the State Director of Finance to invest in obligations of, or guaranteed by, the U.S. Government, obligations of the State, federally insured savings and checking accounts, certificates of deposit, and repurchase agreements with federally insured financial institutions. Cash and deposits with financial institutions are collateralized in accordance with State statutes. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

Receivables—Receivables are reported at their gross value when earned and are reduced by the estimated portion that is expected to be uncollectible. The allowance for uncollectible accounts is based on collection history and current information regarding the credit worthiness of the tenants and others doing business with the Airports Division. When continued collection activity results in receipt of amounts previously written off, revenue is recognized for the amount collected.

Investments—Investments consist primarily of certificates of deposit and repurchase agreements with a maturity of more than three months when purchased. The carrying amounts approximate fair value because of the short maturity of the investments.

Restricted Assets—Restricted assets consist of monies and other resources, the use of which is legally restricted. Certain proceeds of the airports system revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the Statement of Net Assets because they are maintained separately and the use of the proceeds is limited by applicable bond covenants and resolutions. Restricted assets account for the principal and interest amounts accumulated to make debt service payments, unspent bond proceeds, and amounts restricted for bond reserve requirements.

Capital Assets—Capital assets acquired by purchase or construction are recorded at cost. Contributed property is recorded at fair value at the date received, if known. Buildings, improvements, and equipment are depreciated by the straight-line method over their estimated useful lives as follows:

Class of Assets	Estimated Useful Lives	Capitalization Threshold
Land improvements	20 years	\$100,000
Buildings	45 years	100,000
Building improvements	20 years	100,000
Machinery and equipment	10 years	5,000

Disposals of assets are recorded by removing the costs and related accumulated depreciation from the accounts with a resulting gain or loss.

Repairs and maintenance, minor replacements, renewals and betterments are charged against operations for the year. Major replacements, renewals and betterments are capitalized in the year incurred. Interest cost is capitalized during the period of construction for all capital improvement projects except the portion of projects funded by grants from the federal government.

Bond Issue Costs, Original Issue Discount or Premium and Deferred Loss on Refundings—Bond issue costs relating to the issuance of airports system revenue bonds are deferred and are amortized over the life of the respective issue on a straight-line basis. Original issue discount or premium and deferred loss on refundings are amortized using the effective interest method over the terms of the respective issues and are added to or offset against the long-term debt in the Statement of Net Assets.

Accrued Vacation and Compensatory Pay—The Airports Division accrues all vacation and compensatory pay at current salary rates, including additional amounts for certain salary-related expenses associated with the payment of compensated absences (such as employer payroll taxes and fringe benefits), in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. Vacation is earned at the rate of 168 or 240 hours per calendar year, depending upon job classification. Accumulation of such vacation credits is limited to 720 or 1,056 hours at calendar year-end and is convertible to pay upon termination of employment.

Employees' Retirement System—The Airports Division's contributions to the Employees' Retirement System of the State of Hawaii (ERS) are based on the current contribution rate determined by the State

Department of Budget and Finance. The Airports Division's policy is to fund its required contribution annually.

Risk Management—The Airports Division is exposed to various risks of loss from torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. The Airports Division is self-insured for workers' compensation claims as discussed in Note 13. Liabilities related to these losses are reported when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recently Issued Accounting Pronouncements—In May 2002, the GASB issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. This Statement amends Statement 14 to provide additional guidance to determine whether certain organizations for which the primary government is not financially accountable should be reported as component units based on the nature and significance of their relationship with the primary government. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2003. The adoption of Statement No. 39 did not have an impact on the financial statements.

In March 2003, the GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures—an amendment of GASB Statement No. 3*. This Statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this Statement are also to be disclosed. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2004. Management has not completed its determination of the additional disclosures that may be required, once the provisions of this Statement are implemented.

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement establishes accounting and financial reporting standards for impairment of capital assets and also clarifies and establishes accounting requirements for insurance recoveries. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2004. Management has not completed its determination of the impact on the financial statements once the provisions of this Statement are implemented.

Reclassifications—Certain amounts in the 2003 financial statements have been reclassified to conform to the 2004 presentation.

3. CASH AND CASH EQUIVALENTS AND INVESTMENTS

Cash and cash equivalents and investments at June 30, 2004 and 2003 consisted of the following:

	2004	2003
Petty cash	\$ 17,805	\$ 17,805
Cash in State Treasury	744,952,873	734,783,246
Repurchase agreements and certificates of deposit	<u>85,284,176</u>	<u>85,284,176</u>
	<u>\$ 830,254,854</u>	<u>\$ 820,085,227</u>

Such amounts are reflected in the Statement of Net Assets at June 30, 2004 and 2003 as follows:

	2004	2003
Cash and cash equivalents:		
Unrestricted	\$ 592,631,186	\$ 572,889,904
Restricted	<u>152,339,492</u>	<u>161,911,147</u>
Total cash and cash equivalents	744,970,678	734,801,051
Investments--restricted	<u>85,284,176</u>	<u>85,284,176</u>
Total cash and cash equivalents and investments	<u>\$ 830,254,854</u>	<u>\$ 820,085,227</u>

At June 30, 2004 and 2003, information relating to the insurance and collateral of cash deposits was not available since such information is determined on a statewide basis and not for individual departments or divisions. Cash deposits of the State are covered by federal deposit insurance or by collateral held either by the State Treasury or by the State's fiscal agent in the name of the State.

State statutes authorize the Airports Division to invest, with certain restrictions, in obligations of the State or the United States, and in federally insured savings accounts, certificates of deposit, and repurchase agreements with federally insured financial institutions. Money held as reserves may be invested in obligations of the United States, the State, or any subdivision of the State. At June 30, 2004 and 2003, the investments consisted of certificates of deposit and repurchase agreements. Such investments were insured or collateralized with securities held by the State Treasury or by the State's fiscal agent in the name of the State.

Effective August 1, 1999, the State established a policy whereby all unrestricted and certain restricted cash is invested in the State's investment pool. Section 36-21, Hawaii Revised Statutes, authorizes the State to invest in obligations of the State, the U.S. Treasury, agencies and instrumentalities, certificates of deposit, and bank repurchase agreements. The Airports Division records the pooled assets as Cash in State Treasury. At June 30, 2004 and 2003, the amounts held in the investment pool amounted to \$744,953,370 and \$734,770,426, respectively.

Fair values of the Airports Division's certificates of deposit and repurchase agreements approximate cost. The fair value of nonparticipating certificates of deposit and repurchase agreements are reported using a cost-based measure.

4. CAPITAL ASSETS

Capital assets activity for the years ended June 30, 2004 and 2003 consist of the following:

	Balance, July 1, 2003	Increases	Decreases	Transfers	Balance, June 30, 2004
Capital assets not being depreciated:					
Land	\$ 288,853,840	\$ -	\$ -	\$ -	\$ 288,853,840
Land improvements	12,287,797	238,175		11,338,372	23,864,344
Construction in progress	<u>85,643,287</u>	<u>41,176,503</u>	<u>(3,394,169)</u>	<u>(63,812,719)</u>	<u>59,612,902</u>
Total capital assets not being depreciated	<u>386,784,924</u>	<u>41,414,678</u>	<u>(3,394,169)</u>	<u>(52,474,347)</u>	<u>372,331,086</u>
Capital assets being depreciated:					
Land improvements	705,638,341	420,805		19,526,619	725,585,765
Buildings and improvements	1,272,279,381	859,733		29,228,969	1,302,368,083
Machinery and equipment	<u>178,243,289</u>	<u>1,351,091</u>	<u>(11,247,214)</u>	<u>3,718,759</u>	<u>172,065,925</u>
Total capital assets being depreciated	<u>2,156,161,011</u>	<u>2,631,629</u>	<u>(11,247,214)</u>	<u>52,474,347</u>	<u>2,200,019,773</u>
Less accumulated depreciation:					
Land improvements	437,214,309	26,615,893			463,830,202
Buildings and improvements	467,892,443	42,697,569			510,590,012
Machinery and equipment	<u>152,170,498</u>	<u>9,719,156</u>	<u>(11,175,175)</u>		<u>150,714,479</u>
Total depreciation	<u>1,057,277,250</u>	<u>79,032,618</u>	<u>(11,175,175)</u>		<u>1,125,134,693</u>
Capital assets being depreciated—net	<u>1,098,883,761</u>				<u>1,074,885,080</u>
Total capital assets	<u>\$ 1,485,668,685</u>				<u>\$ 1,447,216,166</u>

	Balance, July 1, 2002	Increases	Decreases	Transfers	Balance, June 30, 2003
Capital assets not being depreciated:					
Land	\$ 288,853,840	\$ -	\$ -	\$ -	\$ 288,853,840
Land improvements	12,287,797				12,287,797
Construction in progress	<u>76,207,552</u>	<u>50,210,502</u>		<u>(40,774,767)</u>	<u>85,643,287</u>
Total capital assets not being depreciated	<u>377,349,189</u>	<u>50,210,502</u>		<u>(40,774,767)</u>	<u>386,784,924</u>
Capital assets being depreciated:					
Land improvements	691,381,733	282,276		13,974,332	705,638,341
Buildings and improvements	1,246,316,243	568,051		25,395,087	1,272,279,381
Machinery and equipment	<u>175,090,651</u>	<u>2,506,294</u>	<u>(759,004)</u>	<u>1,405,348</u>	<u>178,243,289</u>
Total capital assets being depreciated	<u>2,112,788,627</u>	<u>3,356,621</u>	<u>(759,004)</u>	<u>40,774,767</u>	<u>2,156,161,011</u>
Less accumulated depreciation:					
Land improvements	410,808,537	26,405,772			437,214,309
Buildings and improvements	426,489,143	41,403,300			467,892,443
Machinery and equipment	<u>142,516,396</u>	<u>10,395,707</u>	<u>(741,605)</u>		<u>152,170,498</u>
Total depreciation	<u>979,814,076</u>	<u>78,204,779</u>	<u>(741,605)</u>		<u>1,057,277,250</u>
Capital assets being depreciated-net	<u>1,132,974,551</u>				<u>1,098,883,761</u>
Total capital assets	<u>\$ 1,510,323,740</u>				<u>\$ 1,485,668,685</u>

During fiscal year 2003, the Airports Division completed the transfer of certain parcels of land to the State Department of Land and Natural Resources to settle its obligations under a 1984 land exchange agreement. As the fair value of the land received was less than the fair value of the land given, the Airports Division received \$2,140,000 in cash. The cash proceeds have been recorded as a gain on disposal of capital assets for fiscal year 2003.

During fiscal year 2003, the Airports Division acquired five buildings upon the expiration of land lease agreements. During fiscal year 2004, the Airports Division acquired one building upon the expiration of the land lease agreement. No amount has been recorded for these acquisitions as of June 30, 2004 as an appraisal at the date of acquisition is not available.

5. LONG-TERM LIABILITIES

A summary of the long-term liabilities changes during fiscal year 2004 and 2003 follows:

	Balance, June 30, 2003	Increases	Decreases	Balance, June 30, 2004	Current	Noncurrent
Workers' compensation	\$ 4,100,000	\$ 1,197,384	\$ (1,197,384)	\$ 4,100,000	\$ 871,392	\$ 3,228,608
Compensated absences	7,310,392	3,101,087	(3,198,972)	7,212,507	2,427,847	4,784,660
General obligation bonds	75,402		(9,427)	65,975	9,425	56,550
Airports system revenue bonds	804,574,740	79,699,860	(110,521,257)	773,753,343	10,765,000	762,988,343
Special facility revenue bonds	40,845,000		(850,000)	39,995,000	1,005,000	38,990,000
	<u>\$856,905,534</u>	<u>\$83,998,331</u>	<u>\$ (115,777,040)</u>	<u>\$825,126,825</u>	<u>\$15,078,664</u>	<u>\$810,048,161</u>

	Balance, June 30, 2002	Increases	Decreases	Balance, June 30, 2003	Current	Noncurrent
Workers' compensation	\$ 4,100,000	\$ 711,948	\$ (711,948)	\$ 4,100,000	\$ 858,782	\$ 3,241,218
Compensated absences	7,252,244	3,129,250	(3,071,102)	7,310,392	2,426,163	4,884,229
General obligation bonds	349,167		(273,765)	75,402	9,427	65,975
Airports system revenue bonds	831,282,780		(26,708,040)	804,574,740	19,550,000	785,024,740
Special facility revenue bonds	41,665,000		(820,000)	40,845,000	850,000	39,995,000
	<u>\$884,649,191</u>	<u>\$ 3,841,198</u>	<u>\$ (31,584,855)</u>	<u>\$856,905,534</u>	<u>\$23,694,372</u>	<u>\$833,211,162</u>

6. AIRPORTS SYSTEM REVENUE BONDS

In 1969, the Director issued the *Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Airports System Revenue Bonds* (Certificate) under which \$40,000,000 of revenue bonds were initially authorized for issuance. Subsequent issues of revenue bonds were covered by first through twenty-eighth supplemental certificates to the original 1969 Certificate.

Certain amendments to the Certificate contained in the Twenty-sixth Supplemental Certificate took effect contemporaneously with the Twenty-seventh Supplemental Certificate and delivery of the Airports System Revenue Bonds, Refunding Series of 2001. Other amendments, which required the consent of 100% of the bondholders, took effect as of June 30, 2004 with the issuance of the Airports System Revenue Bonds, Refunding Series of 2003.

These revenue bonds are payable solely from and are collateralized solely by the revenues generated by the Airports Division including all aviation fuel taxes levied. The amended Certificate established an order of priority for the appropriation, application or expenditure of these revenues as follows:

- a. To pay or provide for the payment of the costs of operation, maintenance, and repair of airport properties.
- b. To pay when due all bonds and interest. Payment shall be provided from the following accounts:
 1. Interest account
 2. Serial bond principal account
 3. Sinking fund account
 4. Debt service reserve account

- c. To fund the major maintenance, renewal and replacement account.
- d. To reimburse the State General Fund for general obligation bond requirements.
- e. To provide for betterments and improvements to the airports.
- f. To provide such special reserve funds and other special funds as created by law.
- g. To provide for any other purpose connected with or pertaining to the bonds or the airports authorized by law.

The primary change effected as of June 30, 2004 is a change in the priority for the use of revenues. Prior to the change, the payment of interest, principal, and sinking fund requirements were the first priority.

The amended Certificate requires that the Airports Division impose, prescribe and collect revenues that, together with unencumbered funds, will yield net revenues and taxes at least equal to 1.25 times the total interest, principal and sinking fund requirements for the ensuing 12 months. The Airports Division is also required to maintain adequate insurance on its properties.

For purposes of calculating the required amounts to be credited to the interest, serial bond principal, sinking fund, debt service reserve, and major maintenance, renewal and replacement accounts (collectively referred to as revenue bond debt service reserve accounts), the Certificate stipulates that investments be valued at the lower of their face amount or fair value. At June 30, 2004 and 2003, amounts credited to the revenue bond debt service reserve accounts were in accordance with applicable provisions of the Certificate.

At June 30, 2004 and 2003, the revenue bond debt service reserve accounts (reported as restricted assets in the accompanying Statement of Net Assets) consisted of the following:

	2004	2003
Debt service reserve account	\$ 85,284,176	\$ 85,284,176
Major maintenance, renewal and replacement account	<u>62,869,215</u>	<u>62,320,411</u>
	148,153,391	147,604,587
Principal and interest due July 1	<u>31,565,869</u>	<u>43,443,083</u>
	<u>\$ 179,719,260</u>	<u>\$ 191,047,670</u>

At June 30, 2004 and 2003, respectively, \$20,193,576 and \$38,696 of authorized but unissued airports system revenue bonds lapsed. On July 1, 2004, there was legislative authorization to issue additional bonds of \$38,400,000.

The revenue bonds are subject to redemption at the option of the Department of Transportation (DOT) and the State during specific years at prices ranging from 102% to 100% of principal.

The following is a summary of airports system revenue bonds issued and outstanding at June 30, 2004 and 2003:

Series	Interest Rate	Final Maturity Date (July 1)	Original Amount of Issue	Outstanding Amount	
				2004	2003
1993, refunding	4.00 - 6.45	2013	\$ 131,035,000	\$ -	\$ 89,900,000
1994, first refunding	4.15 - 5.60	2004	63,455,000	10,765,000	20,725,000
2000A, refunding	5.50 - 6.00	2021	26,415,000	26,415,000	26,415,000
2000B, refunding	5.00 - 8.00	2020	261,465,000	249,275,000	249,275,000
2001, refunding	4.00 - 5.75	2021	423,255,000	423,255,000	423,255,000
2003, refunding	2.00 - var.	2013	<u>80,900,000</u>	<u>69,300,000</u>	
			<u>\$ 986,525,000</u>	779,010,000	809,570,000
Add unamortized premium				15,148,801	16,222,651
Less unamortized discount				(922,487)	(1,226,016)
Less deferred loss on refunding				(19,482,971)	(19,991,895)
Less current portion				<u>(10,765,000)</u>	<u>(19,550,000)</u>
Noncurrent portion				<u>\$ 762,988,343</u>	<u>\$ 785,024,740</u>

Annual debt service requirements to maturity for airports system revenue bonds are as follows:

	Principal	Interest	Total
Year ending June 30:			
2005	\$ 36,750,000	\$ 40,998,898	\$ 77,748,898
2006	42,465,000	39,557,129	82,022,129
2007	44,650,000	37,867,591	82,517,591
2008	33,940,000	36,075,901	70,015,901
2009	26,110,000	34,906,116	61,016,116
2010-2014	188,700,000	150,305,068	339,005,068
2015-2019	294,935,000	81,218,651	376,153,651
2020-2021	<u>100,695,000</u>	<u>7,286,525</u>	<u>107,981,525</u>
	<u>\$ 768,245,000</u>	<u>\$ 428,215,879</u>	<u>\$ 1,196,460,879</u>

The above debt service requirements are set forth based upon funding requirements. Principal and interest payments are required to be funded in the 12-month and 6-month periods, respectively, preceding the date on which the payments are due. Accordingly, the above debt service requirements do not present principal and interest payments due on July 1, 2004.

The following is a summary of interest costs incurred for the years ended June 30, 2004 and 2003 and the allocation thereof:

	2004	2003
Expensed as incurred	\$ 40,284,848	\$ 44,054,273
Capitalized in capital assets	<u>4,467,804</u>	<u>4,208,853</u>
	<u>\$ 44,752,652</u>	<u>\$ 48,263,126</u>

On May 23, 2001, the Airports Division deposited \$172,638,362 from the Airport Revenue Fund in a separate irrevocable trust with an escrow agent to defease \$158,335,000 of its outstanding Second Series of 1991, Second Refunding Series of 1994, and Third Refunding Series of 1994 bonds (collectively the "defeased bonds"). The funds were used to purchase non-callable direct obligations of the United States, maturing in amounts and bearing interest at such rates sufficient to meet the debt service requirements of the defeased bonds. The defeased bonds are to be redeemed at a price ranging from 100% to 102% at dates ranging from July 1, 2004 to July 1, 2012. As a result, the liability for the defeased bonds has been removed from the financial statements.

On August 26, 2003, the Airports Division issued \$80,900,000 of Airports System Revenue Bonds, Refunding Series of 2003, with an initial rate of 2% per annum to June 30, 2004, which will be converted to a weekly rate, fixed rate, or extended rate, at the option of the Airports Division, to refund the \$80,310,000 of its outstanding Refunding Series of 1993 bonds with interest rates ranging from 6.05% to 6.45%. The net proceeds of \$80,500,484 (after payment of \$1,080,694 in underwriting fees, insurance, and other costs), along with an additional \$2,535,170 from the Airport Revenue Fund were deposited in an irrevocable trust with an escrow agent to be used to purchase non-callable direct obligations of the United States, maturing in amounts and bearing interest at such rates sufficient to meet the debt service requirements of the Refunding Series of 1993 bonds. On or about September 25, 2003, the refunded bonds were redeemed at a price of 102%. As a result, the refunded portion of the Refunding Series of 1993 bonds is considered to be defeased and the liability for those bonds has been removed from the financial statements.

The refunding resulted in a difference between the reacquisition price and the net carrying amount of the refunded debt of \$1,881,318. This difference, reported in the accompanying financial statements as a deduction from airports system revenue bonds, is being charged to operations over the next 10 years. The Airports Division in effect reduced its aggregate debt service payments by approximately \$16,195,000 over the next 10 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of approximately \$15,204,000.

7. GENERAL OBLIGATION BONDS

The Airports Division reimburses the State for the portion of debt service on several general obligation bonds issued by the State, the proceeds of which were used to finance various airport projects. These bonds are backed by the full faith and credit of the State.

The following is a summary of such general obligation bonds reimbursable by the Airports Division at June 30, 2004 and 2003:

Series	Interest Rate	Final Maturity Date	Original Amount of Issue	Outstanding Amount	
				2004	2003
CI	4.00 - 5.00	2011	\$ 141,392	\$ 65,975	\$ 75,402
Less current portion				<u>(9,425)</u>	<u>(9,427)</u>
Noncurrent portion				<u>\$ 56,550</u>	<u>\$ 65,975</u>

Annual debt service requirements for general obligation bonds outstanding at June 30, 2004 are as follows:

	Principal	Interest	Total
Year ending June 30:			
2005	\$ 9,425	\$ 2,865	\$ 12,290
2006	9,425	2,446	11,871
2007	9,425	2,017	11,442
2008	9,425	1,579	11,004
2009	9,425	1,133	10,558
2010-2011	<u>18,850</u>	<u>916</u>	<u>19,766</u>
	<u>\$ 65,975</u>	<u>\$ 10,956</u>	<u>\$ 76,931</u>

The following is a summary of interest costs incurred for the years ended June 30, 2004 and 2003 and the allocation thereof:

	2004	2003
Expensed as incurred	\$ 2,835	\$ 4,644
Capitalized in capital assets	<u>373</u>	<u>392</u>
	<u>\$ 3,208</u>	<u>\$ 5,036</u>

8. LEASES

Airport-Airline Lease Agreement

Airports Division

The DOT and the airline companies serving the airports system (signatory airlines) operated pursuant to an airport-airline lease agreement that was originally set to expire on July 31, 1992 (lease agreement). Under the lease agreement, the signatory airlines each have the nonexclusive right to use the facilities, equipment, improvements, and services of the airports system and to occupy certain premises and facilities thereon. The lease agreement was extended under a series of five subsequent agreements, the last of which was executed in June 1994, and extended the expiration date to June 30, 1997 (hereafter the lease agreement and the five subsequent agreements are collectively referred to as the "lease extension agreement"). The lease extension agreement contains a provision under which the expiration date is automatically extended on a quarterly basis after June 30, 1997, unless terminated by either party upon at least 60 days prior written notice. As of the date hereof, the lease extension agreement remains in effect, with annual ad-hoc adjustments to airports system rates and charges and related terms.

Under the lease extension agreement, the airports system rates and charges are calculated using a residual rate-setting methodology that excludes duty free revenues in excess of \$100 million per year and any interest income earned on funds set aside for the Capital Improvements Program. The airports system rates and charges consist of the following: (1) exclusive use terminal charges based on appraisal and recovered on a per square foot basis, (2) joint use premises charges (for nonexclusive use of terminal space) based on appraisal and recovered on a per revenue passenger landing basis, (3) international arrivals building charges based on appraisal and recovered on a per deplaning international passenger basis, (4) landing fees based on a cost center residual rate setting methodology and recovered on a revenue landing landed weight basis (per thousand pound units), and (5) system support charges

based on an airports system residual rate setting methodology and recovered on a revenue landing landed weight basis (per thousand pound units).

Prepaid Airport Use Charge Fund

In August 1995, the DOT and the signatory airlines entered into an agreement to extend the Prepaid Airport Use Charge Fund (PAUCF). During fiscal year 2000, the parties discussed the transfer of the signatory airlines' net excess payments into the PAUCF. Net excess payments for fiscal years 1996 through 2002 have been transferred to the PAUCF. In fiscal years 2004 and 2003, the signatory airlines were paid \$1,348,000 and \$460,000, respectively, out of the PAUCF.

Aviation Fuel Tax

The aviation fuel tax amounted to \$2,931,685 and \$2,854,123 for fiscal years 2004 and 2003, respectively. In May 1996, the State Department of Taxation issued a tax information release that effective July 1, 1996, the Hawaii fuel tax will not apply to the sale of bonded aviation/jet fuel to air carriers departing for foreign ports or arriving from foreign ports on stopovers before continuing on to their final destination.

Airports System Rates and Charges

Signatory and nonsignatory airlines were assessed the following airports system rates and charges.

Airport landing fees amounted to \$36,838,817 and \$37,330,350 for fiscal years 2004 and 2003, respectively. Airport landing fees are shown net of aviation fuel tax credits of \$3,321,555 and \$2,750,659 for fiscal years 2004 and 2003, respectively, on the Statement of Revenues, Expenses and Changes in Net Assets, which resulted in net airport landing fees of \$33,517,262 and \$34,579,691 for fiscal years 2004 and 2003, respectively. Airport landing fees are based on a computed rate per 1,000-pound units of approved maximum landing weight for each aircraft used in revenue landings. The inter-island airport landing fees for signatory airlines are set at 36% of the airport landing fees for overseas flights.

Overseas and inter-island joint-use premise charges were established to recover airports system costs allocable to the overseas and inter-island terminals joint-use space based on terminal rental rates and are recovered based on a computed rate per revenue passenger landing. Nonexclusive joint-use premise charges for terminal rentals amounted to \$24,902,421 and \$25,095,942 for fiscal years 2004 and 2003, respectively. For fiscal year 2004, the State waived \$1,637,867 of signatory airlines underpayment of nonexclusive joint-use premise charges and will transfer \$414,657 of overpayments into the PAUCF. For fiscal year 2003, the underpayment of \$1,438,346 was waived.

Effective July 1, 1996, a joint-use premise charge for the neighbor isle terminals at Kahului Airport, Kona International Airport at Keahole, Lihue Airport, and Hilo International Airport was established to recover from signatory airlines airports system costs allocable to the baggage claim, baggage tug drive and joint-use baggage makeup areas based on terminal rental rates and are recovered based on a computed rate per revenue passenger landing in accordance with the lease extension agreement. Effective March 1, 1997, a blended overseas joint-use premise charge was established to recover costs allocable to Hawaiian Airlines, Inc.'s and Aloha Airlines, Inc.'s consolidated terminal operations at the Honolulu International Airport.

International arrivals building charges were established to recover airports system costs allocable to the international arrivals area based on terminal rental rates and are recovered based on a computed rate per deplaning international passenger using the international arrivals area. Beginning fiscal year 2000,

nonsignatory airline revenue was applied as a credit in calculating the joint-use premise charge and international arrivals building charges.

Exclusive-use premise charges amounted to \$27,092,618 and \$27,697,345 for fiscal years 2004 and 2003, respectively, and are computed using a fixed rate per square footage per year. Exclusive-use premise charges for terminal rentals amounted to \$15,181,760 and \$15,616,153 for fiscal years 2004 and 2003, respectively.

Airports system support charges amounted to \$710,659 and \$896,109 for fiscal years 2004 and 2003, respectively, and were established to recover all remaining residual costs of the airports system. Airports system support charges were established by Administrative Rules for nonsignatory airlines. Those rates are based on a computed rate per 1,000-pound units of approved maximum landing weight for each aircraft used in revenue landings. The airports system inter-island support charges for nonsignatory airlines are set at 32% of airports system support charges for overseas flights.

The following summarizes the rates in effect at June 30, 2004 and 2003:

	2004	2003
Airport landing fees (per 1,000 pound units of landed weights):		
Signatory airlines:		
Overseas flights	\$ 1.930	\$ 1.930
Inter-island flights	0.695	0.695
Nonsignatory airlines:		
Overseas flights	2.980	2.980
Inter-island flights	0.954	0.954
Nonexclusive joint-use premise charges:		
Overseas and inter-island terminal joint-use charges (per revenue passenger landing):		
Signatory airlines:		
Overseas terminal	520.372	520.372
Blended overseas	400.140	400.140
Inter-island terminal	77.281	77.281
Nonsignatory airlines:		
Overseas terminal	457.344	457.344
Inter-island terminal	69.375	69.375
International arrivals building charges (per deplaning international passenger):		
Signatory airlines	4.029	4.029
Nonsignatory airlines	3.346	3.346
Neighbor-island terminals joint-use charges (per revenue passenger landing)—Signatory airlines	15.378	15.378
Airports system support charges (per 1,000 pound units of landed weights)—Nonsignatory airlines:		
Overseas flights	0.618	0.618
Inter-island flights	0.198	0.198

Special Facility Leases and Revenue Bonds

The Airports Division entered into four special facility lease agreements with: Delta Airlines, Inc. in 1987, Continental Airlines, Inc. in November 1997 and July 2000, and Caterair International Corporation in December 1990, which was subsequently assigned to Sky Chefs, Inc. effective January 2002. The construction of the related facilities was financed by special facility revenue bonds issued by the Airports Division in the amounts of \$2,300,000, \$25,255,000, \$16,600,000, and \$6,600,000, respectively. These bonds are payable solely from and collateralized solely by certain rentals and other monies derived from the special facility. Other pertinent information on the aforementioned bonds is summarized hereunder.

\$2,300,000 Issue

Bonds with a stated maturity date of June 1, 2005 remain outstanding. The bonds are subject to early redemption, at the option of the Airports Division, at 100% of principal.

The bonds bear interest at 6.50% per annum. Maturities of the revenue bonds, including amounts subject to mandatory redemption at par, will require principal payments of \$185,000 and interest payments of \$12,025 (total \$197,025) in 2005 based on the amounts outstanding at June 30, 2004.

\$25,255,000 Issue

Bonds with a stated maturity date of November 15, 2027 remain outstanding. The bonds are subject to redemption at the option of the Airports Division, upon the request of Continental Airlines, Inc., at prices ranging from 101% to 100% of principal depending on the dates of redemption or, if the facilities are destroyed or damaged extensively, at 100% plus interest. During the year ended June 30, 2000, the Airports Division redeemed \$3,400,000 in bonds.

The bonds bear interest at 5.625% per annum. Interest-only payments of \$614,672 are due semi-annually on May 15 and November 15 of each year until the bonds mature on November 15, 2027, at which time the entire principal amount is due. The following principal and interest payments are required based on the amounts outstanding at June 30, 2004:

	Principal	Interest	Total
Year ending June 30:			
2005	\$ -	\$ 1,229,344	\$ 1,229,344
2006		1,229,344	1,229,344
2007		1,229,344	1,229,344
2008		1,229,344	1,229,344
2009		1,229,344	1,229,344
2010-2014		6,146,719	6,146,719
2015-2019		6,146,719	6,146,719
2020-2024		6,146,719	6,146,719
2025-2028	<u>21,855,000</u>	<u>4,302,701</u>	<u>26,157,701</u>
	<u>\$ 21,855,000</u>	<u>\$ 28,889,578</u>	<u>\$ 50,744,578</u>

\$16,600,000 Issue

On July 15, 2000, the Airports Division issued \$16,600,000 of term special facility bonds (Continental Airlines, Inc.), Refunding Series of 2000, to refund \$18,225,000 of its outstanding Series of 1990 (Continental Airlines, Inc.).

The bonds are subject to redemption on or after June 1, 2010, at the option of the Airports Division, upon the request of Continental Airlines, Inc. or, if the facilities are destroyed or damaged extensively, at 100% of principal plus interest.

The bonds bear interest at 7% per annum. Maturities of the revenue bonds, including amounts subject to mandatory redemption at par, will require the following principal and interest payments based on the amounts outstanding at June 30, 2004:

	Principal	Interest	Total
Year ending June 30:			
2005	\$ 520,000	\$ 1,025,850	\$ 1,545,850
2006	565,000	989,450	1,554,450
2007	600,000	949,900	1,549,900
2008	640,000	907,900	1,547,900
2009	700,000	863,100	1,563,100
2010-2014	4,225,000	3,521,000	7,746,000
2015-2019	5,965,000	1,814,750	7,779,750
2020-2024	<u>1,440,000</u>	<u>100,800</u>	<u>1,540,800</u>
	<u>\$ 14,655,000</u>	<u>\$ 10,172,750</u>	<u>\$ 24,827,750</u>

\$6,600,000 Issue

Bonds with a stated maturity date of December 1, 2010 remain outstanding. The bonds are subject to redemption on or after December 1, 2000, at the option of the Airports Division, upon the request of Sky Chefs, Inc., at prices ranging from 103% to 100% of principal depending on the dates of redemption or, if the facilities are destroyed or damaged extensively, at 100% plus interest.

The bonds bear interest at 10.125% per annum. Maturities of the revenue bonds, including amounts subject to mandatory redemption at par, will require the following principal and interest payments based on the amounts outstanding at June 30, 2004:

	Principal	Interest	Total
Year ending June 30:			
2005	\$ 300,000	\$ 329,063	\$ 629,063
2006	400,000	293,625	693,625
2007	400,000	253,125	653,125
2008	400,000	212,625	612,625
2009	400,000	172,125	572,125
2010-2011	<u>1,400,000</u>	<u>177,187</u>	<u>1,577,187</u>
	<u>\$ 3,300,000</u>	<u>\$ 1,437,750</u>	<u>\$ 4,737,750</u>

Special facility revenue bonds payable at June 30, 2004 and 2003 consisted of the following:

2004	Delta	Continental		Sky Chefs	Total
Current portion	\$ 185,000	\$ 520,000	\$ -	\$ 300,000	\$ 1,005,000
Noncurrent portion		<u>14,135,000</u>	<u>21,855,000</u>	<u>3,000,000</u>	<u>38,990,000</u>
	<u>\$ 185,000</u>	<u>\$ 14,655,000</u>	<u>\$ 21,855,000</u>	<u>\$ 3,300,000</u>	<u>\$ 39,995,000</u>
2003					
Current portion	\$ 170,000	\$ 480,000	\$ -	\$ 200,000	\$ 850,000
Noncurrent portion	<u>185,000</u>	<u>14,655,000</u>	<u>21,855,000</u>	<u>3,300,000</u>	<u>39,995,000</u>
	<u>\$ 355,000</u>	<u>\$ 15,135,000</u>	<u>\$ 21,855,000</u>	<u>\$ 3,500,000</u>	<u>\$ 40,845,000</u>

The special facility leases are accounted for and recorded as direct financing leases. The remaining lease payments to be paid by the lessees (including debt service requirements on the special facility revenue bonds) are recorded as an asset and the special facility revenue bonds outstanding are recorded as a liability in the accompanying Statement of Net Assets.

Net investments in direct financing leases at June 30, 2004 and 2003 consisted of the following:

	2004	2003
Cash with bond fund trustee	\$ 3,297,878	\$ 3,590,889
Receivable from lessees—net of unearned interest of \$40,244,102 and \$42,899,879	36,697,122	37,254,111
Interest receivable	<u>268,001</u>	<u>273,410</u>
	<u>\$40,263,001</u>	<u>\$41,118,410</u>

Other Operating Leases

The Airports Division also leases certain building spaces and improvements to concessionaires, airline carriers and other airport users. The terms of these leases range from 4 to 15 years for concessionaires and up to 65 years for other airport users. Information regarding the cost and related accumulated depreciation of these facilities, which is required to be disclosed by Statement of Financial Accounting Standards No. 13, *Accounting for Leases*, is not provided because the accumulation of such data was not considered practical and because the information, when compared to the future minimum rentals to be received, would not be an accurate indication of the productivity of the property on lease or held for lease, due to the methods by which and the long period of time over which the properties were acquired.

The future minimum rentals from these operating leases at June 30, 2004 are as follows:

Year ending June 30:	
2005	\$ 62,133,120
2006	56,122,058
2007	14,675,535
2008	13,578,961
2009	8,166,043
2010-2014	34,927,931
2015-2019	24,835,414
2020-2024	12,343,875
2025-2029	5,642,073
2030-2032	<u>305,412</u>
	<u>\$ 232,730,422</u>

The leases with concessionaires are generally based on the greater of a percentage of sales or a minimum guarantee. Percentage rents included in concession fees for fiscal years 2004 and 2003 were approximately \$49,837,000 and \$44,219,000, respectively.

Concession fee revenues from the DFS Group, L.P. (DFS), which operates the in-bond (Duty Free) concession, the Honolulu International Airport retail concession, and the Kona International Airport retail concession, accounted for approximately 57% and 48% of total concession fee revenues for fiscal years 2004 and 2003, respectively.

As of June 30, 2003, DFS was in significant arrears in the rents due to the Airports Division as a result of financial difficulties arising from the downturn in Hawaii's economy due to the decrease in international visitor travel. Although the Governor had granted temporary rent relief to the Airports Division's concessionaires during fiscal years 2002 and 2003, the major concessionaire was unable to bring the rent due to a current basis.

After significant negotiations between the State and DFS, both parties entered into a Withdrawal and Settlement Agreement (Agreement) effective August 1, 2003, which included the following terms:

- DFS was required to bring all of its accounts payable under the in-bond lease, as modified by the Agreement, current.
- DFS was required to bring all of its accounts payable under the retail concession agreement, in accordance with their terms, current.
- DFS executed a promissory note to the State for \$6,024,102, which represented underpaid rent from January through May 2003 under the in-bond lease. The note accrues interest at the annual rate of 5% and is due no later than May 31, 2006. The note is collateralized by a performance bond.
- The State exercised its authority to withdraw and recapture all of the leased premises and to terminate early the in-bond lease.
- DFS was allowed to submit a qualifying bid proposal paying at lease the minimum upset rent for the new in-bond lease.

DFS was the only bidder for the new in-bond lease and was awarded the contract on September 29, 2003.

The new contract provides for a minimum annual guarantee rent as well as percentage rent on annual gross receipts exceeding certain levels. Highlights of the terms of the new contract are as follows:

Term	Minimum Annual Guarantee	Percentage Rent		
		For Total Concession Receipts	On-Airport Sales	Off-Airport Sales
10/1/03 – 5/31/04	\$26,700,000	> \$100m and < \$133m;	22.5%	18.5%
		> \$133m	30.0%	22.5%
6/1/04 – 5/31/05	\$37,311,121	> \$160m and < \$200m;	22.5%	18.5%
		> \$200m	30.0%	22.5%
6/1/05 – 5/31/06	\$37,311,121	> \$165m and < \$200m;	22.5%	18.5%
		> \$200m	30.0%	22.5%

The DFS Honolulu International Airport retail concession contract, effective March 15, 2001, provides for payment of 20% of gross sales against minimum annual guarantee payments aggregating \$47,250,000 over the five-year contract.

The DFS Honolulu International Airport concession contracts provide for quarterly advance payments due on March 1, June 1, September 1, and December 1 of each year.

9. PENSION INFORMATION

All full-time employees of the Airports Division are eligible to participate in the ERS, a cost-sharing multiple-employer public employee retirement system established to administer a pension benefit program for all state and county employees. The ERS was established by Chapter 88, Hawaii Revised Statutes, and is governed by a Board of Trustees. All contributions, benefits and eligibility requirements are established by Chapter 88, Hawaii Revised Statutes, and can be amended by legislative action.

The ERS is composed of a contributory retirement plan and a noncontributory retirement plan. Eligible employees who were in service and a member of the existing contributory plan on June 30, 1984, were given an option to remain in the existing plan or join the noncontributory plan, effective January 1, 1985. All new eligible employees hired after June 30, 1984, automatically become members of the noncontributory plan. Both plans provide death and disability benefits and cost of living increases. Benefits are established by state statute. In the contributory plan, employees may elect normal retirement at age 55 with 5 years of credited service or elect early retirement at any age with 25 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 2% of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching five years of service; retirement benefits are actuarially reduced for early retirement. Covered contributory plan employees are required by state statute to contribute 7.8% of their salary to the plan; the Airports Division is required by state statute to contribute the remaining amounts necessary to pay contributory plan benefits when due. In the noncontributory plan, employees may elect normal retirement at age 62 with 10 years of credited service or at age 55 with 30 years of credited service, or elect early retirement

at age 55 with 20 years of credited service. Such employees are entitled to retirement benefits, payable monthly for life, of 1.25% of their average final salary, as defined, for each year of credited service. Benefits fully vest on reaching ten years of service; retirement benefits are actuarially reduced for early retirement. The Airports Division is required by state statute to contribute all amounts necessary to pay noncontributory plan benefits when due.

The pension contribution for fiscal years 2004 and 2003 was \$3,472,098 and \$3,352,651, respectively, which represented 8.9% of covered payroll and was equal to the required contribution for the year.

The ERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the ERS, 201 Merchant Street, Suite 1400, Honolulu, Hawaii, 96813 or by calling (808) 586-1660.

10. POSTRETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS

In addition to providing pension benefits, the State provides certain health care (medical, prescription drug, vision, and dental) and life insurance benefits for retired employees. Contributions are financed on a pay-as-you-go basis, and are limited by state statute to the actual cost of benefit coverage. The Airports Division pays for 100% of these benefits for employees who have at least 10 years of service. The Airports Division's share of the cost of these benefits is pro-rated for employees with less than 10 years of service. The Airports Division also reimburses Medicare expenses of retirees and qualified spouses (through the State) who are at least 62 years of age and have at least 10 years of service. Contributions are financed on a pay-as-you-go basis, and are limited by state statute to the actual cost of benefit coverage. The amounts allocated to the Airports Division for fiscal years 2004 and 2003 amounted to \$2,815,238 and \$2,872,858, respectively.

11. TRANSACTIONS WITH OTHER GOVERNMENT AGENCIES

The State assesses a surcharge of 5% for central service expenses on all receipts of the Airports Division, after deducting any amounts pledged, charged or encumbered, for the payment of bonds and interest during the year. The assessments amounted to \$9,771,402 and \$8,517,875 in fiscal years 2004 and 2003, respectively.

The Airports Division is assessed a percentage of the cost of the general administration expenses of the DOT. The assessments amounted to \$6,077,191 and \$4,762,533 in fiscal years 2004 and 2003, respectively. During fiscal years 2004 and 2003, the Airports Division received assessment refunds from the DOT amounting to \$421,770 and \$1,185,295, respectively. Such refunds reduced operating expenses in the accompanying Statement of Revenues, Expenses and Changes in Net Assets.

During fiscal years 2004 and 2003, revenues received from other state agencies totaled \$303,648 and \$558,551, respectively, and expenditures to other state agencies totaled \$5,356,997 and \$5,261,441, respectively.

The Airports Division also recorded a gain of \$2,140,000 for proceeds received from the State in exchange for land transfers completed during fiscal year 2003 as described in Note 4 above.

12. COMMITMENTS

Sick Pay

Accumulated sick leave at June 30, 2004 and 2003 was \$14,950,969 and \$14,791,265, respectively. Sick leave accumulates at the rate of 14 or 20 hours per month of service without limit, depending on the

employee's job classification, but can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for sick pay is recorded. However, an Airports Division's employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit with the ERS.

Deferred Compensation Plan

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

Other

Under an agreement with the Federal Bureau of Prisons (FBOP), the Airports Division is required to perform certain upgrades to its utilities infrastructure, which is also used by the Federal Detention Center adjacent to the Honolulu International Airport. In exchange, the FBOP has paid a connection fee to the Airports Division of \$952,601. The upgrades are expected to be performed in the next 5-10 years. Accordingly, the amount has been recorded as a noncurrent customer advance on the Statement of Net Assets at June 30, 2004.

At June 30, 2004 and 2003, the Airports Division had commitments totaling approximately \$83,757,000 and \$110,143,000, respectively, for construction and service contracts.

13. RISK MANAGEMENT

The Airports Division is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees.

Torts

The Airports Division is involved in various actions, the outcome of which, in the opinion of management, will not have a material adverse effect on the Airports Division's financial position. Losses, if any, are either covered by insurance or will be paid from legislative appropriations of the State General Fund, except as described in Note 14.

Property and Liability Insurance

The Airports Division is covered by commercial general liability policies with a \$300 million limit per occurrence. These commercial general liability policies have no deductible and cover bodily injuries and property damage for occurrences arising out of the ownership, operation, and maintenance of state airports.

Workers' Compensation

The State is self-insured for workers' compensation. Accordingly, the Airports Division is liable for all workers' compensation claims filed by its employees. Liabilities for workers' compensation claims are established if information indicates that it is probable that liabilities have been incurred and the amount of those claims can be reasonably estimated. The basis for estimating the liabilities for unpaid claims includes the effects of specific incremental claim adjustment expenses, salvage, and subrogation, and other allocated or unallocated claim adjustment expenses. These liabilities include an amount for claims that have been incurred but not reported. At June 30, 2004 and 2003, the workers' compensation reserve

was \$4,100,000 in both years, of which \$871,392 and \$858,782 are included in other current liabilities (payable from current assets) and \$3,228,608 and \$3,241,218 are included in long-term liabilities in the accompanying Statements of Net Assets at June 30, 2004 and 2003, respectively. In the opinion of management, the Airports Division has adequately reserved for such claims.

14. CONTINGENT LIABILITIES AND OTHER

Litigation

The State is subject to a number of lawsuits arising in the ordinary course of its airport operations. While the ultimate liabilities, if any, in the disposition of these matters are presently difficult to estimate, it is management's belief that the outcomes are not likely to have a material adverse effect on the Airports Division's financial position. In addition, the State has not determined whether the ultimate liabilities, if any, will be imposed on the Airport Revenue Fund. Accordingly, no provisions for any liabilities that might result have been made in the accompanying financial statements.

Arbitrage

In compliance with the requirements of Section 148 of the Internal Revenue Code of 1986, as amended, the Airports Division is required to calculate rebates due to the U.S. Treasury on the airports system revenue bonds issued since 1986. Rebates are calculated by bond series based on the amount by which the cumulative amount of investment income exceeds the amount that would have been earned had funds been invested at the bond yield. In the opinion of management, rebates payable as of June 30, 2004 and 2003, if any, are not material to the financial statements. Accordingly, no rebates payable have been recorded in the accompanying financial statements.

Asserted Claims

Prepaid Airport Use Charge Fund

In November 2002, the Airlines Committee of Hawaii (ACH), on behalf of many of the signatory airlines, submitted a written request to the State for the return of \$5,393,344. This amount purportedly represents the amount of landing fees and other charges allegedly overpaid by the signatory airlines in fiscal year 1995.

On October 27, 2003, the State reached a settlement with the ACH under which the Airports Division is to transfer the \$5,393,344 overpayment to the Prepaid Airport Use Charge Fund escrow account in four equal annual installments beginning in fiscal year 2004. The transfer of funds is to be subject to ACH's obtaining the State's prior written approval for ACH's use of such funds. A liability for the refund has been recorded in the Airports Division's financial statements as of June 30, 2004, with an offsetting charge to airports system support charges revenues.

Ceded Lands

Since the passage of Public Law 105-66 on October 27, 1997, the Office of Hawaiian Affairs (OHA) has not received airport revenues for the Airports Division's use of ceded lands at its airports. Public Law 105-66 provides in part that "[t]here shall be no further payment of airport revenues for claims related to ceded lands, whether characterized as operating expense, rent, or otherwise, and whether related to claims for periods of time prior to or after the date of enactment of this Act."

On July 21, 2003, OHA filed a lawsuit against the State of Hawaii, OHA v. State of Hawaii, Civil No. 03-1-1505-07 (First Circuit), for (1) the State's alleged breaches of its fiduciary duties as trustee of the

ceded lands public trust, (2) its alleged violation of the U.S. Constitution, the Hawaii State Constitution, Act 304, Session Laws of Hawaii 1990, and Chapter 10, Hawaii Revised Statutes, and (3) its alleged failure to properly account for and pay OHA certain monies OHA alleges are due OHA from the use of ceded lands, including monies for the use of ceded lands at the Airports Division's airports since the passage of Public Law 105-66.

The claims made in OHA v. State of Hawaii are asserted against the State and not the Airports Division. The State intends to vigorously defend against all of OHA's claims, and the State Attorney General is of the view that OHA's claims are without merit. Accordingly, no provision for any payments of monies claimed by OHA has been recorded in the financial statements as of June 30, 2004.

Environmental Protection Agency

The Airports Division has been notified of certain violations of the Clean Water Act by the Environmental Protection Agency. Although settlement of the violations is considered to be likely, the Airports Division is unable to estimate the potential fines or penalties that may be imposed and, accordingly, an accrual has not been recorded as of June 30, 2004.

Criminal Investigation

In fiscal year 2002, the State Attorney General launched a criminal investigation into allegations of forgery, conspiracy to commit theft, theft, and bribery relating to small purchase contracts issued by the Airports Division. The investigation covers the 1997 through 2002 fiscal years. As of the date of this report, several Airports Division employees have been arrested, and the investigation is continuing.

Through June 30, 2004, the Airports Division received \$83,500 in restitution.

The effect, if any, on the June 30, 2004 financial statements as a result of the ultimate resolution of the investigation is presently unknown.

* * * * *

STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

Schedule 1

OPERATING REVENUES AND OPERATING EXPENSES OTHER THAN DEPRECIATION
YEAR ENDED JUNE 30, 2004

	Total	Statewide	Airports					
			Honolulu International	Hilo International	Kona International at Keahole	Kahului	Lihue	All Others
Operating revenues:								
Concession fees	\$ 114,738,758	\$ -	\$ 82,352,013	\$ 6,444,688	\$ 1,936,765	\$ 16,795,421	\$ 6,970,640	\$ 239,231
Airport landing fees	33,517,262		22,917,239	793,133	2,334,926	5,408,903	1,662,158	400,903
Aeronautical rentals:								
Exclusive-use premise charges	27,092,618		23,188,125	692,710	985,275	1,283,667	735,536	207,305
Nonexclusive joint-use premise charges	24,902,421		23,824,210	90,161	478,284	318,371	191,395	
Nonaeronautical rentals	12,060,261		7,085,297	646,203	435,141	3,208,990	600,679	83,951
Aviation fuel tax	2,931,685		2,004,523	69,374	204,231	473,105	145,386	35,066
Airports system support charges	(4,682,685)		(3,729,688)	(91,910)	(120,814)	(537,549)	(154,093)	(48,631)
Miscellaneous	4,318,430		2,913,246	106,407	352,909	543,687	344,577	57,604
Total operating revenues	\$ 214,878,750	\$ -	\$ 160,554,965	\$ 8,750,766	\$ 6,606,717	\$ 27,494,595	\$ 10,496,278	\$ 975,429
Operating expenses other than depreciation:								
Salaries and wages	\$ 50,912,748	\$ 5,864,251	\$ 23,401,577	\$ 3,415,425	\$ 3,732,817	\$ 6,467,802	\$ 4,499,895	\$ 3,530,981
Other personnel services	37,535,231	2,489,227	21,177,073	2,404,265	2,584,054	5,193,017	2,335,004	1,352,591
Utilities	18,622,657		12,856,366	827,366	1,227,213	2,090,481	1,236,604	384,627
Repairs and maintenance	10,102,772	305,260	7,067,737	615,991	635,031	789,759	417,706	271,288
State of Hawaii surcharge on gross receipts (Note 1)	9,771,402	9,771,402						
Department of Transportation general administration expenses	5,655,422	5,655,422						
Special maintenance	5,222,256	1,149	2,005,976	642,825	705,444	528,399	920,974	417,489
Materials and supplies	4,664,290	430,994	2,092,644	304,980	346,351	654,540	408,865	425,916
Insurance	2,647,008	2,640,724	9,629	(367)	(1,637)	(1,342)		1
Claims and benefits	1,279,127	27,229	694,582	122,834	102,772	186,435	130,979	14,296
Bad debt expense	923,511	923,511						
Communication	372,192	93,910	97,794	18,421	24,263	56,816	27,380	53,608
Rent	268,590	71,403	88,542	4,767	13,154	40,454	34,128	16,142
Travel	262,254	26,514	62,519	31,077	41,519	41,748	28,682	30,195
Dues and subscriptions	85,389	73,364	4,546	1,115	1,031	1,991	2,442	900
Freight and delivery	15,659	953	4,371	1,559	366	2,413	392	5,605
Printing and advertising	12,712	8,699	845			3,120		48
Miscellaneous	265,617	123,891	54,127	19,750	31,536	9,107	18,573	8,633
	148,618,837	28,507,903	69,618,328	8,410,008	9,443,914	16,064,740	10,061,624	6,512,320
Allocation of statewide expenses (Note 2)	-	(28,507,903)	16,523,663	1,996,085	2,241,479	3,812,909	2,388,091	1,545,676
Total operating expenses other than depreciation for net revenues and taxes	148,618,837	-	86,141,991	10,406,093	11,685,393	19,877,649	12,449,715	8,057,996
Disbursements out of major maintenance, renewal and replacement account not included above	1,192,459		29,285	6,916	1,156,097		161	
Total operating expenses other than depreciation for statement of revenues, expenses and changes in net assets	\$ 149,811,296	\$ -	\$ 86,171,276	\$ 10,413,009	\$ 12,841,490	\$ 19,877,649	\$ 12,449,876	\$ 8,057,996

NOTES:

(1) State of Hawaii surcharge on gross receipts consists of transfers to the State General Fund to defray central service expenses as required by HRS Section 36-28.5.

(2) Statewide expenses are allocated to the airports based upon their respective current-year operating expenses to total current-year operating expenses for all airports.

See accompanying independent auditors' report.

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

**CALCULATIONS OF NET REVENUES AND TAXES AND
DEBT SERVICE REQUIREMENT
YEAR ENDED JUNE 30, 2004**

REVENUES AND TAXES:

Concession fees		\$ 114,738,758
Aeronautical rentals:		
Exclusive-use premise charges		27,092,618
Nonexclusive joint-use premise charges		24,902,421
Airport landing fees		33,517,262
Nonaeronautical rentals		12,060,261
Aviation fuel tax		2,931,685
Airports system support charges		(4,682,685)
Interest income, exclusive of interest on investments in direct financing leases and including interest income of \$11,225,793 on capital improvement projects		17,928,374
Federal operating grants		1,480,168
Miscellaneous		<u>4,318,430</u>
		234,287,292

DEDUCTIONS:

Operating expenses other than depreciation for net revenues and taxes (Schedule 1)	\$ 148,618,837	
Amounts required to be paid into the State General Fund for general obligation bond requirements:		
Principal	9,427	
Interest	3,208	
Annual reserve required on major maintenance, renewal, and replacement account	<u>3,085,099</u>	<u>151,716,571</u>
Net revenues and taxes		82,570,721

DEBT SERVICE REQUIREMENT:

Airports system revenue bonds:		
Principal	\$ 22,365,000	
Interest (Note 1)	<u>43,813,909</u>	
	66,178,909	
Less credits to the interest account (Note 2)	<u>(25,000,000)</u>	
	41,178,909	
Debt service coverage percentage	<u>125%</u>	<u>51,473,636</u>
EXCESS OF NET REVENUES AND TAXES OVER DEBT SERVICE REQUIREMENT		<u>\$ 31,097,085</u>

(Continued)

**STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)**

**CALCULATIONS OF NET REVENUES AND TAXES AND DEBT SERVICE REQUIREMENT
YEAR ENDED JUNE 30, 2004**

Notes:

1. For purposes of calculating the debt service requirement, interest payments for airports system revenue bonds exclude the amortization of the deferred loss on refunding and original issue discount and premium, which are reported as interest expense for financial statement reporting purposes.
2. In fiscal year 2004, the Airports Division deposited \$25,000,000 of available funds into the Airport Revenue Fund for credit to the interest account in the current year to reduce the amount required pursuant to the provisions of Section 6.01 to be paid or credited during fiscal year 2004 to the interest account as required in the "Certificate of the Director of Transportation Providing for the Issuance of State of Hawaii Airports System Revenue Bonds."

See accompanying independent auditors' report.

(Concluded)

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

SUMMARY OF DEBT SERVICE REQUIREMENTS TO MATURITY
JUNE 30, 2004

Year Ending June 30	Annual Principal and Interest Requirements				
	Airports System Revenue Bonds		General Obligation Bonds		Total
	Principal	Interest	Principal	Interest	
2005	\$ 36,750,000	\$ 40,998,898	\$ 9,425	\$ 2,865	\$ 77,761,188
2006	42,465,000	39,557,129	9,425	2,446	82,034,000
2007	44,650,000	37,867,591	9,425	2,017	82,529,033
2008	33,940,000	36,075,901	9,425	1,579	70,026,905
2009	26,110,000	34,906,116	9,425	1,133	61,026,674
2010	27,615,000	33,605,699	9,425	686	61,230,810
2011	29,340,000	31,966,186	9,425	231	61,315,842
2012	31,245,000	30,269,561			61,514,561
2013	51,100,000	28,629,746			79,729,746
2014	49,400,000	25,833,876			75,233,876
2015	52,355,000	22,869,649			75,224,649
2016	55,500,000	19,726,999			75,226,999
2017	58,750,000	16,471,134			75,221,134
2018	62,295,000	12,934,356			75,229,356
2019	66,035,000	9,216,513			75,251,513
2020	69,665,000	5,577,400			75,242,400
2021	31,030,000	1,709,125			32,739,125
Total	<u>\$ 768,245,000</u>	<u>\$ 428,215,879</u>	<u>\$ 65,975</u>	<u>\$ 10,957</u>	<u>\$ 1,196,537,811</u>

See accompanying independent auditors' report.

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

DEBT SERVICE REQUIREMENTS TO MATURITY—AIRPORTS SYSTEM REVENUE BONDS
JUNE 30, 2004

Year Ending June 30	Principal				Total	Interest	Total Requirements
	Refunding Series of 2000A, 5.50% to 6.00%	Refunding Series of 2000B, 5.00% to 8.00%	Refunding Series of 2001, 4.00% to 5.75%	Refunding Series of 2003, 2.00% to Var. Rate (1.00%)			
2005	\$ -	\$ 9,455,000	\$ 15,795,000	\$ 11,500,000	\$ 36,750,000	\$ 40,998,898	\$ 77,748,898
2006		10,035,000	20,530,000	11,900,000	42,465,000	39,557,129	82,022,129
2007		10,660,000	21,590,000	12,400,000	44,650,000	37,867,591	82,517,591
2008		11,295,000	9,845,000	12,800,000	33,940,000	36,075,901	70,015,901
2009	145,000	11,830,000	10,335,000	3,800,000	26,110,000	34,906,116	61,016,116
2010	155,000	12,550,000	10,910,000	4,000,000	27,615,000	33,605,699	61,220,699
2011	160,000	13,550,000	11,530,000	4,100,000	29,340,000	31,966,186	61,306,186
2012	170,000	14,640,000	12,135,000	4,300,000	31,245,000	30,269,561	61,514,561
2013	180,000	15,580,000	30,840,000	4,500,000	51,100,000	28,629,746	79,729,746
2014	190,000	16,595,000	32,615,000		49,400,000	25,833,876	75,233,876
2015	200,000	17,665,000	34,490,000		52,355,000	22,869,649	75,224,649
2016	215,000	18,815,000	36,470,000		55,500,000	19,726,999	75,226,999
2017	225,000	19,960,000	38,565,000		58,750,000	16,471,134	75,221,134
2018	240,000	21,285,000	40,770,000		62,295,000	12,934,356	75,229,356
2019	125,000	22,845,000	43,065,000		66,035,000	9,216,513	75,251,513
2020	8,400,000	22,515,000	38,750,000		69,665,000	5,577,400	75,242,400
2021	16,010,000		15,020,000		31,030,000	1,709,125	32,739,125
Total	<u>\$ 26,415,000</u>	<u>\$ 249,275,000</u>	<u>\$ 423,255,000</u>	<u>\$ 69,300,000</u>	<u>\$ 768,245,000</u>	<u>\$ 428,215,879</u>	<u>\$ 1,196,460,879</u>

NOTE: For purposes of this schedule, the above debt service requirements are set forth based upon funding requirements. Principal and interest payments are required to be funded in the 12-month and 6-month periods, respectively, preceding the date on which the payments are due. Accordingly, this schedule does not present the principal and interest payments due on July 1, 2004.

See accompanying independent auditors' report.

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

DEBT SERVICE REQUIREMENTS TO MATURITY—GENERAL OBLIGATION BONDS
JUNE 30, 2004

Year Ending June 30	Series CI 4.00% to 5.00% Due 2011	Total Principal	Interest	Total Requirements
2005	\$ 9,425	\$ 9,425	\$ 2,865	\$ 12,290
2006	9,425	9,425	2,446	11,871
2007	9,425	9,425	2,017	11,442
2008	9,425	9,425	1,579	11,004
2009	9,425	9,425	1,133	10,558
2010	9,425	9,425	686	10,111
2011	<u>9,425</u>	<u>9,425</u>	<u>230</u>	<u>9,655</u>
Total	<u>\$ 65,975</u>	<u>\$ 65,975</u>	<u>\$ 10,956</u>	<u>\$ 76,931</u>

See accompanying independent auditors' report.

STATE OF HAWAII, DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

Schedule 6

AIRPORTS SYSTEM CHARGES—FISCAL YEAR 1995-97 LEASE EXTENSION
YEAR ENDED JUNE 30, 2004

	Airline Activity				Airports System Charges							Total
	Approved Maximum Revenue Landing Weights (1,000 Pound Units)	Revenue Passenger Landings	Deplaning International Passengers	Airport Landing Fees	Airports System Support Charges	Nonexclusive Joint-Use Premise Charges	Joint-Use Charges— Blended OST Terminal	Joint-Use Charges— Interisland Terminal	Joint-Use Charges— Neighbor Island Terminal	International Arrivals Building Charges	Exclusive- Use Premise Charges— Terminal Space	
Signatory airlines:												
Air Canada	463,600	1,365	75,958	\$ 894,748	\$ -	\$ 610,917	\$ -	\$ -	\$ 2,937	\$ 306,035	\$ 435,331	\$ 2,249,968
Air New Zealand, Ltd.	50,198	157	24,635	96,882		81,698				99,254	209,834	487,668
Air Pacific, Ltd.	30,352	212	14,496	58,579		110,319				58,404		227,302
All Nippon Airways Co., Ltd.	12,688	26	7,398	24,488		13,530				29,807	11,232	79,057
Aloha Airlines, Inc.	5,316,598	39,075	11,406	4,241,140			558,195	1,363,005	308,221	45,955	2,213,155	8,729,671
American Airlines, Inc.	1,700,738	6,099		3,282,425		1,717,748			43,027		774,110	5,817,310
ATA Airlines, Inc.	455,050	2,078		878,002		672,841			12,072		243,359	1,806,274
China Airlines, Ltd.	206,947	362	110,499	357,371		188,375				445,200	169,615	1,160,561
Continental Airlines, Inc.	643,440	1,787		1,238,381		756,101			5,136		1,186,366	3,185,984
Continental Micronesia, Inc.	153,980	540	111,096	297,181		281,001				447,606	(14,875)	1,010,913
Delta Airlines, Inc.	803,330	2,311		1,549,130		999,635			5,997		1,161,162	3,715,924
Evergreen International Airlines, Inc.	5,445			10,509								10,509
Federal Express Corporation	485,287			936,604							7,006	943,610
Hawaii Island Air, Inc.	571,927			397,489							166,850	564,339
Hawaiian Airlines, Inc.	5,940,810	44,024	38,378	6,019,500			1,695,793	1,465,170	320,278	154,625	1,734,873	11,390,239
JALways Co., Ltd.	429,600	909	235,635	829,128		473,018				949,373		2,251,519
Japan Air Lines Company, Ltd.	1,406,951	2,734	730,258	2,511,086		1,232,761			5,613	2,942,210	1,385,840	8,077,510
Kalitta Air, LLC	187,470			361,817								361,817
Korean Airlines Company, Ltd.	182,554	252	63,404	352,329		131,134				255,455	176,011	914,929
Northwest Airlines, Inc.	1,058,992	2,285	280,353	2,043,854		1,088,098			2,983	1,129,542	1,002,638	5,267,115
Philippine Airlines	356,059	137	26,742	687,194		71,291				107,744	112,811	979,040
Polar Air Cargo, Inc.	160,974			310,679								310,679
Qantas Airways, Ltd.	86,948	161	45,369	167,810		83,780				182,792	343,830	778,212
United Airlines, Inc.	2,614,311	8,602	177,045	5,045,620		2,124,158			69,509	713,314	3,328,809	11,281,410
United Parcel Service Co.	577,951			820,664							4,057	824,721
Nonsignatory airlines	1,681,593	1,413	92,407	3,426,207	710,659	646,227				309,194	529,747	5,622,034
Total airports system charges billed	25,583,793	114,529	2,045,079	36,838,817	710,659	11,282,632	2,253,988	2,828,175	775,773	8,176,510	15,181,761	78,048,315
Adjusted airports system charges based on final reconciliation				36,838,817	710,659	10,377,915	2,197,969	3,755,664	985,157	9,217,583	15,181,761	79,265,525
Fiscal year 2004 net underpayment						\$ (904,717)	\$ (56,019)	\$ 927,489	\$ 209,384	\$ 1,041,073	\$ -	\$ 1,217,210
Specific application of overpayments to underpayments						\$ 490,060	\$ 56,019	\$ (56,019)	\$ -	\$ (490,060)	\$ -	\$ -
Fiscal year 2004 underpayment waived							(871,470)	(871,470)	(209,384)	(551,013)		(1,631,867)
Fiscal year 2004 overpayment due to signatory airlines						414,657						414,657
Net underpayment						\$ 904,717	\$ 56,019	\$ (927,489)	\$ (209,384)	\$ (1,041,073)	\$ -	\$ (1,217,210)

See accompanying independent auditors' report.

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

RECONCILIATION OF AIRPORT LANDING FEES
YEAR ENDED JUNE 30, 2004

	Signatory Airlines	Nonsignatory Airlines	Total
Gross airport landing fees billed	\$33,412,610	\$ 3,426,207	\$36,838,817
Less aviation fuel tax credit	<u>(3,193,359)</u>	<u>(128,196)</u>	<u>(3,321,555)</u>
Total	<u>\$30,219,251</u>	<u>\$ 3,298,011</u>	<u>\$33,517,262</u>

**STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)**

**UNDERPAYMENT OF AIRPORTS SYSTEM CHARGES—SIGNATORY AIRLINES
YEARS ENDED JUNE 30, 2004 AND 2003**

FISCAL YEARS 2004 AND 2003

Airports system charges underpayments of \$1,631,867 and \$1,438,346 were waived for fiscal years 2004 and 2003, respectively, due to the September 11, 2001 terrorist attacks and subsequent decline in the airline and tourism markets.

See accompanying independent auditors' report.

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

Schedule 7

APPROVED MAXIMUM REVENUE LANDING WEIGHTS AND AIRPORT LANDING FEES—SIGNATORY AIRLINES
YEAR ENDED JUNE 30, 2004

	Approved Maximum Revenue Landing Weights (1,000 pound units)				Honolulu International Airport and Hilo International Airport Gross Airport Landing Fees					All Other Airports			Total Adjusted Airport Landing Fees
	Honolulu International Airport	Hilo International Airport	All Other Airports	Total	Honolulu International Airport	Hilo International Airport	Total	Aviation Fuel Tax Credit	Adjusted Airport Landing Fees	Gross Airport Landing Fees	Aviation Fuel Tax Credit	Adjusted Airport Landing Fees	
Air Canada	409,386	-	54,214	463,600	\$ 790,115	\$ -	\$ 790,115	\$ -	\$ 790,115	\$ 104,633	\$ -	\$ 104,633	\$ 894,748
Air New Zealand, Ltd.	50,198			50,198	96,882		96,882		96,882				96,882
Air Pacific, Ltd.	30,352			30,352	58,579		58,579		58,579				58,579
All Nippon Airways Co., Ltd.	12,688			12,688	24,488		24,488		24,488				24,488
Aloha Airlines, Inc.	2,566,645	478,533	2,271,420	5,316,598	2,044,466	332,900	2,377,366	(445,482)	1,931,884	1,863,774		1,863,774	3,795,658
American Airlines, Inc.	968,878		731,860	1,700,738	1,869,935		1,869,935	(530,234)	1,339,701	1,412,490		1,412,490	2,752,191
ATA Airlines, Inc.	283,500		171,550	455,050	546,910		546,910	(152,052)	394,858	331,092		331,092	725,950
China Airlines, Ltd.	206,947			206,947	357,372		357,372		357,372				357,372
Continental Airlines, Inc.	526,540		116,900	643,440	1,012,764		1,012,764	(204,540)	808,224	225,617	(28,556)	197,061	1,005,285
Continental Micronesia, Inc.	153,980			153,980	297,181		297,181		297,181				297,181
Delta Airlines, Inc.	666,830		136,500	803,330	1,286,982		1,286,982	(218,859)	1,068,123	262,148		262,148	1,330,271
Evergreen International Airlines, Inc.	5,445			5,445	10,509		10,509		10,509				10,509
Federal Express Corporation	390,065	95,222		485,287	752,825	183,779	936,604	(66,410)	870,194				870,194
Hawaii Island Air, Inc.	250,080		321,847	571,927	173,806		173,806		173,806	223,683		223,683	397,489
Hawaiian Airlines, Inc.	3,444,170	270,930	2,225,710	5,940,810	4,057,885	188,296	4,246,181	(586,733)	3,659,448	1,773,318		1,773,318	5,432,766
JALways Co., Ltd.	429,600			429,600	829,128		829,128		829,128				829,128
Japan Air Lines Company, Ltd.	1,241,502		165,449	1,406,951	2,191,769		2,191,769		2,191,769	319,317	(8,050)	311,267	2,503,036
Kalitta Air, LLC	187,470			187,470	361,817		361,817		361,817				361,817
Korean Airlines Company, Ltd.	182,554			182,554	352,329		352,329		352,329				352,329
Northwest Airlines, Inc.	984,569		74,423	1,058,992	1,900,218		1,900,218	(314,333)	1,585,885	143,636		143,636	1,729,521
Philippine Airlines, Inc.	356,059			356,059	687,194		687,194		687,194				687,194
Polar Air Cargo Inc.	160,974			160,974	310,679		310,679		310,679				310,679
Qantas Airways, Ltd.	86,948			86,948	167,810		167,810		167,810				167,810
United Airlines, Inc.	1,492,278		1,122,033	2,614,311	2,880,097		2,880,097	(550,520)	2,329,577	2,165,523	(45,017)	2,120,506	4,450,083
United Parcel Service Co.	339,262		238,689	577,951	654,775		654,775	(42,573)	612,202	165,889		165,889	778,091
Total	15,426,920	844,685	7,630,595	23,902,200	\$23,716,515	\$704,975	\$24,421,490	\$(3,111,736)	\$21,309,754	\$8,991,120	\$ (81,623)	\$8,909,497	\$30,219,251
Summary of revenue landing weights:													
Overseas				13,637,749									
Interisland				10,264,451									
				23,902,200									

Aviation fuel tax of \$2,931,685 was paid by the users for the year ended June 30, 2004. Users can claim a credit for aviation fuel taxes paid. Nonsignatory airlines have up to six months after payment to claim the credit. Signatory airlines are not subject to such limitation and can claim a credit for taxes paid at any time. Aviation fuel tax credits of \$3,321,555 were credited against airport landing fees in accordance with Article V.E. of the Airport Airline Lease agreement as follows:

Signatory airlines	\$ 3,193,359
Nonsignatory airlines	128,196
	<u>\$ 3,321,555</u>

NOTE 1: The above schedule presents airport landing fees billed to signatory airlines for the year ended June 30, 2004.

See accompanying independent auditors' report.

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION—AIRPORTS DIVISION
(An Enterprise Fund of the State of Hawaii)

Schedule 8

APPROVED MAXIMUM REVENUE LANDING WEIGHTS AND AIRPORT LANDING FEES—NONSIGNATORY AIRLINES
YEAR ENDED JUNE 30, 2004

	Approved Maximum Revenue Landing Weights (1,000 pound units)				Honolulu International Airport and Hilo International Airport Gross Airport Landing Fees					All Other Airports			Total Adjusted Airport Landing Fees
	Honolulu International Airport	Hilo International Airport	All Other Airports	Total	Honolulu International Airport	Hilo International Airport	Total	Aviation Fuel Tax Credit	Adjusted Airport Landing Fees	Gross Airport Landing Fees	Aviation Fuel Tax Credit	Adjusted Airport Landing Fees	
Aero Micronesia dba Asia Pacific	34,112	-	-	34,112	\$ 101,654	\$ -	\$ 101,654	\$ -	\$ 101,654	\$ -	\$ -	\$ -	\$ 101,654
Air Japan Co., Ltd.	145,600			145,600	433,888		433,888		433,888				433,888
Air Nevada Airlines, Inc.	24,982	9,036	64,022	98,040	23,832	8,620	32,452		32,452	61,077		61,077	93,529
Air Transport International	60,591			60,591	180,561		180,561		180,561				180,561
Alika Aviation Inc.			11,485	11,485						10,957		10,957	10,957
Aloha Airlines, Inc.-Supplemental	6,042		288	6,330	18,005		18,005		18,005	567		567	18,572
Alpine Aviation, Inc.	8,854	2,152	5,017	16,023	8,747	2,053	10,800		10,800	4,787		4,787	15,587
Aris Inc.			15,788	15,788						15,062	(1,567)	13,495	13,495
Atlas Air, Inc.	36,450			36,450	108,621		108,621		108,621				108,621
Bradley Pacific Aviation Inc.	20,213	219	49,830	70,262	51,879	279	52,158	(35,857)	16,301	118,173	(5,548)	112,625	128,926
Century Aviation, Inc.	13,569		4,868	18,437	38,640		38,640	(3,414)	35,226	12,125		12,125	47,351
Corporate Air	38,059	13,913	9,954	61,926	36,308	13,273	49,581		49,581	9,496		9,496	59,077
Gemini Air Cargo	10,773			10,773	32,104		32,104		32,104				32,104
Hawaii Air Ambulance	15,599	41	601	16,241	14,882	39	14,921	(1,837)	13,084	573		573	13,657
Heli USA Airways	10,982			10,982	10,477		10,477		10,477				10,477
Helicopter Consultants of Maui		45,931	39,016	84,947		43,818	43,818	(7,086)	36,732	37,221	(346)	36,875	73,607
Island Helicopters Kauai			18,667	18,667						17,808	(1,147)	16,661	16,661
Kamaka Air Inc.	2,886		14,749	17,635	2,753		2,753		2,753	14,070		14,070	16,823
Lufthansa Cargo AG	78,105			78,105	232,753		232,753		232,753				232,753
Molokai-Lanai Air Shuttle, Inc.	21,546		24,309	45,855	20,555		20,555		20,555	23,190		23,190	43,745
North American Airlines	57,857	3,780	76,957	138,594	115,408	3,606	119,014		119,014	221,674		221,674	340,688
Oahu Northshore Aviation, Ltd.			24,184	24,184						23,071		23,071	23,071
Ohana Aviation Inc.			10,237	10,237						9,766	(1,058)	8,708	8,708
Omni Air International, Inc.	199,131		411	199,542	593,410		593,410	(47,267)	546,143	1,225		1,225	547,368
Pacific Helicopter Tours Inc.	468		11,463	11,931	446		446		446	10,936	(5,457)	5,479	5,925
Polynesian, Limited	7,446			7,446	22,188		22,188		22,188				22,188
Safari Aviation, Inc.		5,033	16,438	21,471		4,801	4,801	(107)	4,694	15,682	(1,240)	14,442	19,136
Sky-Med Inc.			20,250	20,250						19,319		19,319	19,319
Skycraft Air Maintenance, Ltd.	84	70	13,133	13,287	80	66	146		146	12,529		12,529	12,675
Will Squyres Helicopters, Inc.			20,844	20,844						19,885		19,885	19,885
Sunshine Helicopters Inc.		4,278	21,657	25,935		4,081	4,081		4,081	20,661	(3,845)	16,816	20,897
Trans Executive Airlines of Hawaii, Inc. dba Trans Air	21,810		44,282	66,092	20,806		20,806	(4,288)	16,518	42,245	(2,410)	39,835	56,353
Universal Enterprise	47,209	3,708	56,741	107,658	123,353	9,392	132,745		132,745	132,234		132,234	264,979
Miscellaneous	78,185	6,114	71,573	155,872	214,666	7,030	221,696	(2,599)	219,097	68,800	(3,123)	65,677	284,774
Total	940,553	94,275	646,764	1,681,592	\$2,406,016	\$97,058	\$2,503,074	\$(102,455)	\$2,400,619	\$ 923,133	\$(25,741)	\$ 897,392	\$3,298,011
Summary of revenue landing weights:													
Overseas				899,266									
Interisland				782,326									
				1,681,592									

NOTE 1: The above schedule presents airport landing fees billed to nonsignatory airlines for the year ended June 30, 2004.

See accompanying independent auditors' report.